No. 91-1513-CFX
Status: GRANTED

Docketed:
March 17, 1992

Title: United States Department of the Treasury and Mitchell A. Levine, Assistant Commissioner, Petitioners
v.
George Fabe, Superintendent of Insurance of Ohio

Court: United States Court of Appeals for the Sixth Circuit

Counsel for petitioner: Solicitor General

Counsel for respondent: Rishel,James

021092 ext til 032092 by Stevens, J.-CITED

Entry	Date	Note	Proceedings and Orders
1	Feb 7 1992	G	Application (A91-575) to extend the time to file a petition for a writ of certiorari from February 19, 1992 to March 20, 1992, submitted to Justice Stevens.
2	Feb 10 1992		Application (A91-575) granted by Justice Stevens extending the time to file until March 20, 1992.
3	Mar 17 1992	G	Petition for writ of certiorari filed.
5	Apr 13 1992		Brief of respondent George Fabe in opposition filed.
4	Apr 15 1992		DISTRIBUTED. May 15, 1992
6	May 18 1992		Petition GRANTED.
			**
8	Jun 22 1992		Order extending time to file brief of petitioner on the merits until July 23, 1992.
9	Jul 23 1992		Brief of petitioners U.S. Dept. of Treasury, et al. filed.
10	Jul 23 1992	G	Motion of the Solicitor General to dispense with printing the joint appendix filed.
11	Jul 27 1992		Record filed.
		*	Partial proceedings United States Court of Appeals for the Sixth Circuit.
13	Aug 12 1992		Order extending time to file brief of respondent on the merits until September 8, 1992.
15	Sep 1 1992		Brief amici curiae of Michigan, et al. filed.
20	Sep 3 1992		Brief amicus curiae of James A. Gordon, Insurance Commr.of Maryland filed.
14	Sep 4 1992		Motion of the Solicitor General to dispense with printing the joint appendix GRANTED.
16	Sep 4 1992		Brief of respondent George Fabe filed.
21	Sep 4 1992		Brief amicus curiae of Lewis Melahn filed.
17	Sep 8 1992		Brief amici curiae of Council of State Governments, et al. filed.
18	Sep 8 1992		Brief amicus curiae of Salvatore R. Curiale filed.
19	Sep 8 1992		Brief amici curiae of Bureau of Insurance, Commonwealth of Virginia, et al. filed.
22	Sep 8 1992		Brief amici curiae of National Conference of Insurance Guaranty Funds, et al. filed.
23	Sep 8 1992		Brief amicus curiae of National Conference of Insurance Legislators filed.
24	Sep 8 1992		Brief amicus curiae of Stephen F. Selcke, Director filed.
25	Sep 8 1992		Brief amicus curiae of National Association of Insurance

Entry	Date	Note	Proceedings and Orders
			Commissioners filed.
26	Oct 9 1992		Reply brief of petitioner filed.
27	Oct 13 1992		SET FOR ARGUMENT TUESDAY, DECEMBER 8, 1992. (2ND CASE).
28	Oct 15 1992		CIRCULATED.
29	Nov 18 1992		Record filed.
		*	Original proceedings United States District Court for the Southern District of Ohio.
30	Dec 8 1992		ARGUED.

No.

In the Supreme Court of the United States

OCTOBER TERM, 1991

UNITED STATES DEPARTMENT OF THE TREASURY AND MITCHELL A. LEVINE, ASSISTANT COMMISSIONER, PETITIONERS

v.

GEORGE FABE, SUPERINTENDENT OF INSURANCE, STATE OF OHIO

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

KENNETH W. STARR
Solicitor General

STUART M. GERSON
Assistant Attorney General

MAUREEN E. MAHONEY
Deputy Solicitor General

ROBERT A. LONG, JR.
Assistant to the Solicitor General

WILLIAM G. KANTER
JENNIFER H. ZACKS
Attorneys

Department of Justice
Washington, D.C. 20530
(202) 514-2217

QUESTION PRESENTED

The federal priority statute, 31 U.S.C. 3713(a)(1)(A), requires that a debtor's obligations to the United States be given first priority in state insolvency proceedings. An Ohio statute provides that claims of the United States are entitled to fifth priority in proceedings to liquidate an insolvent insurance company. The federal priority statute preempts the state priority statute unless the state statute is subject to the anti-preemption provisions of the McCarran-Ferguson Act, 15 U.S.C. 1012. Accordingly, the question presented is:

Whether a state statute establishing the priority of creditors' claims in a proceeding to liquidate an insolvent insurance company is a law regulating "the business of insurance" within the meaning of the McCarran-Ferguson Act.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases:

In the Supreme Court of the United States

OCTOBER TERM, 1991

No.

UNITED STATES DEPARTMENT OF THE TREASURY AND MITCHELL A. LEVINE, ASSISTANT COMMISSIONER, PETITIONERS

v.

GEORGE FABE, SUPERINTENDENT OF INSURANCE, STATE OF OHIO

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

The Solicitor General, on behalf of the United States Department of the Treasury, respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Sixth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-30a) is reported at 939 F.2d 341. The opinion of the district court (App., *infra*, 31a-49a) is unreported.

JURISDICTION

The judgment of the court of appeals (App., *infra*, 50a-51a) was entered on July 17, 1991. A petition for rehearing was denied on November 21, 1991.

App., *infra*, 52a-53a. On February 10, 1992, Justice Stevens extended the time for filing a petition for a writ of certiorari to and including March 20, 1992. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY PROVISIONS INVOLVED

The federal priority statute, 31 U.S.C. 3713 (a)(1)(A), provides, in part:

> A claim of the United States shall be paid first when—
>
> (A) a person indebted to the Government is insolvent and—
>
> (i) the debtor without enough property to pay all debts makes a voluntary assignment of property;
>
> (ii) property of the debtor, if absent, is attached; or
>
> (iii) an act of bankruptcy is committed.

The McCarran-Ferguson Act, 15 U.S.C. 1012, provides, in part:

> (a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.
>
> (b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance * * * unless such Act specifically relates to the business of insurance.

STATEMENT

1. In 1986, an Ohio court declared American Druggists' Insurance Company (ADIC) insolvent. The court ordered that ADIC be liquidated and appointed respondent to serve as liquidator. The United States filed claims in excess of $10.7 million in the liquidation proceeding on immigration, appearance, performance, and payment bonds issued by ADIC as surety. The United States asserted first priority for its claims on the basis of the federal priority statute, 31 U.S.C. 3713(a)(1)(A). App., *infra*, 2a.

Respondent brought a declaratory judgment action in federal district court seeking to establish that the federal priority statute does not preempt an Ohio statute establishing the priority of the claims in insurance liquidation proceedings. Under the Ohio statute, claims of federal, state, and local governments are entitled to fifth priority, ranking behind (1) administrative expenses, (2) wage and benefit claims, (3) policyholders' claims, and (4) claims of general creditors. See Ohio Rev. Code Ann. § 3903.42 (Anderson 1989). Respondent argued that the Ohio priority statute, rather than the federal priority statute, governs the claims of the United States because of the anti-preemption provisions of the McCarran-Ferguson Act. App., *infra*, 2a-3a.

The district court entered summary judgment for the United States. App., *infra*, 31a-49a. The court concluded that a state statute establishing the priority of claims against an insolvent insurance company does not regulate the "business of insurance" within the meaning of the McCarran-Ferguson Act. Accordingly, the court held that the federal priority statute governs the priority of the federal claims.[1]

[1] The district court also held that claims of laborers, materialmen, and subcontractors suing on payment bonds under the Miller Act, 40 U.S.C. 270b, are not claims of the United States for purposes of the federal insolvency statute. See App., *infra*, 45a-48a. The government did not appeal from that ruling.

2. The court of appeals reversed. App., *infra*, 1a-30a. The court applied the three-part test for determining whether a practice is part of the business of insurance:

> [*F*]*irst*, whether the practice has the effect of transferring or spreading a policyholder's risk; *second*, whether the practice is an integral part of the policy relationship between the insurer and the insured; and *third*, whether the practice is limited to entities within the insurance industry.

App., *infra*, 9a (quoting *Union Labor Life Ins. Co.* v. *Pireno*, 458 U.S. 119, 129 (1982)). The court of appeals recognized that the two other courts of appeals that have decided the question "[b]oth rejected the argument that * * * liquidation priority statutes * * * regulate[] the 'business of insurance.'" App., *infra*, 15a (citing *Idaho ex rel. Soward* v. *United States*, 858 F.2d 445 (9th Cir. 1988), cert. denied, 490 U.S. 1065 (1989); *Gordon* v. *United States Dep't of the Treasury*, 846 F.2d 272 (4th Cir.), cert. denied, 488 U.S. 954 (1988)). The court nevertheless held that the Ohio priority statute regulates the business of insurance because it "is a state regulation which protects the interests of the insured." App., *infra*, 20a.

The court held that the Ohio priority statute meets all three parts of the *Pireno* test. First, the court of appeals concluded that the Ohio statute has the effect of transferring and spreading the policyholder's risk that the insurer will become insolvent. App., *infra*, 21a-22a. Second, the court concluded that the priority statute is an integral part of the relationship between the insurer and the insured because it is designed to protect that relationship by providing as-

surances as to the reliability of insurance policies. *Id.* at 22a. Finally, although the court recognized that not all creditors of an insolvent insurance company are policyholders, it concluded that the third prong of *Pireno* was satisfied because the "focus" of the statute is on the protection of policyholders. *Id.* at 23a.

Judge Edgar concurred separately. App., *infra*, 23a-25a. He observed that, in enacting the McCarran-Ferguson Act, Congress intended "to restore the law to its status prior to [*United States* v.] *South-Eastern Underwriters* [*Ass'n*, 322 U.S. 533 (1944)]." App., *infra*, 24a. Judge Edgar concluded that the McCarran-Ferguson Act did not modify the "long standing, traditional state regulation of insurance company liquidations." *Ibid.*

Judge Jones dissented. App., *infra*, 25a-30a. As to the first *Pireno* factor, he concluded that the risk of insurer insolvency is "qualitatively distinct from the risk the policyholder seeks to transfer in an insurance contract," App., *infra*, 27a (quoting *Gordon*, 846 F.2d at 273), and rejected the majority's conclusion that the priority statute involves risk transfer and risk spreading. Judge Jones found that the majority's view was contradicted by this Court's conclusion in *Pireno* that "[t]he transfer of risk from insured to insurer is effected by means of the contract between the parties—the insurance policy—and that transfer is complete at the time that the contract is entered." App., *infra*, 27a (quoting 458 U.S. at 130). As to the second *Pireno* factor, Judge Jones concluded that the priority statute is not an integral part of the policy relationship. "Rather than playing an integral role in the policy relationship between insurer and insured," the Ohio priority statute instead "addresses 'the relationship between those left

in the lurch by the expiration of the insurer.'" App., *infra* (quoting *Soward*, 858 F.2d at 454). Finally, Judge Jones concluded that the third *Pireno* factor also supported preemption because the Ohio priority statute is not limited to entities within the insurance industry, but instead governs the rights of all creditors. App., *infra*, 30a.

REASONS FOR GRANTING THE PETITION

1. As the court of appeals recognized (App., *infra*, 15a), the decision in this case squarely conflicts with decisions of the two other courts of appeals that have decided the issue. See *Idaho ex rel. Soward* v. *United States*, 858 F.2d 445 (9th Cir. 1988), cert. denied, 490 U.S. 1065 (1989); *Gordon* v. *United States Dep't of the Treasury*, 846 F.2d 272 (4th Cir.), cert. denied, 488 U.S. 954 (1988). In addition, the court of appeals' decision conflicts with the decisions of state courts. See *In re Union Indemnity*, 551 N.Y.S.2d 446 (Sup. Ct. 1990), aff'd *sub nom. Curiale* v. *United States*, 566 N.Y.S.2d 853 (App. Div. 1991), petition for cert. pending, No. 91-1347; *Langdeau* v. *United States*, 363 S.W.2d 327 (Tex. Civ. App. 1962). The issue has been thoroughly discussed in the three opinions in this case, as well as in the opinions of the other courts that have decided this question. The Sixth Circuit has declined to grant rehearing en banc. App., *infra*, 54a-55a. Accordingly, the issue is ripe for review by this Court.

2. The question presented is an important one. Congress enacted a federal priority statute in the earliest days of the national government, see Act of Mar. 3, 1797, ch. 210, § 5, 1 Stat. 512, 515, to serve the important purpose of "secur[ing] an adequate revenue to sustain the public burdens, and discharge

the public debts." *United States* v. *State Bank of North Carolina*, 31 U.S. (6 Pet.) 29, 35 (1832). See *United States* v. *Moore*, 423 U.S. 77, 82 (1975); *King* v. *United States*, 379 U.S. 329 (1964).

The Ohio priority statute, like similar priority statutes enacted by other States, ranks claims of the United States behind several other classes of claims.[2] Under these statutes, the United States will often recover little or nothing on its claims against insolvent insurers. The effect on the federal revenue is significant. Nearly $11 million is at stake in this case alone. The issue has assumed even greater practical significance as the rate of insurance company insolvencies has increased. See generally Staff of House Comm. on Energy and Finance, 101st Cong., 2d Sess., *Failed Promises: Insurance Company Insolvencies* 2 (Comm. Print 1990) (noting that nearly half of 150 property-casualty insurance company insolvencies since 1969 occurred within the last five years, and that insurance company assessments to cover the costs of insolvencies amounted to $900 million in 1987, nearly half the total assessments of $2.2 billion for the period from 1969 to 1987).

3. The court of appeals' conclusion that the McCarran-Ferguson Act permits state governments to deny the United States the first priority otherwise mandated by 31 U.S.C. 3713(a) in insurance company insolvency proceedings conflicts with this Court's precedents. State statutes governing the liquidation of insurance companies come into play

---

[2] The state priority statutes at issue in *Gordon* and *Soward* provide additional examples. See Md. Ann. Code art. 48A, §§ 158-158A (1986) (assigning fourth priority to claims of the United States as policyholder); Idaho Code § 41-3342 (1990) (assigning fifth priority to claims of the United States).

only when an insurance company's business has failed and the company is being liquidated. As such, those statutes are specialized bankruptcy laws. They are not laws regulating the "business of insurance" within the meaning of the McCarran-Ferguson Act.

The Court has recognized that much of the business of insurers is not the "business of insurance." *Group Life & Health Ins. Co.* v. *Royal Drug Co.*, 440 U.S. 205, 211 (1979) (price agreements between insurer and pharmacies are not the business of insurance). See also *Union Labor Life Ins. Co.* v. *Pireno*, 458 U.S. 119 (1982) (use of peer review committee to determine whether charges are covered by insurance policy is not the business of insurance); *SEC* v. *National Securities, Inc.*, 393 U.S. 453 (1969) (regulation of the relationship between the insurance company and its stockholders is not the business of insurance). The Ohio priority statute fails the three-part test established by this Court for determining whether a statute regulates the business of insurance.[3]

a. The Ohio priority statute does not have the effect of transferring and spreading a policyholder's risk. The Court has explained that "[t]he primary elements of an insurance contract are the spreading and underwriting of a policyholder's risk. * * * [T]he concept of 'insurance' involves some investment risk-taking on the part of the company." *Royal Drug*, 440 U.S. at 211-212 (quoting *SEC* v. *Variable Annuity Life Ins. Co.*, 359 U.S. 65, 71 (1959)). In *Pireno*, the Court further explained that "[t]he transfer of risk from insured to insurer is effected by means of the contract between the parties—the insurance policy—and that transfer is complete at the time that the contract is entered." 458 U.S. at 130.

[3] As the court of appeals recognized (Pet. App. 11a), the *Pireno* test is not limited to cases involving the antitrust laws. See *Pilot Life Ins. Co.* v. *Dedeaux*, 481 U.S. 41 (1987) (ERISA); *Metropolitan Life Ins. Co.* v. *Massachusetts*, 471 U.S. 724 (1985) (ERISA); *SEC* v. *National Securities, Inc.*, 393 U.S. 453 (1969) (securities laws); *SEC* v. *Variable Annuity Life Ins. Co.*, 359 U.S. 65 (1959) (securities laws).

In this case, the risk of insurer insolvency is not one of the risks covered by the insurance policy. In addition, the covered risk is transferred when the insurance contract is executed, not when the insured submits a claim. And the priority statute does not result in any underwriting or investment risk-taking by the insurance company. Thus, the Ohio statute is "logically and temporally unconnected to the transfer of risk accomplished by [the] insurance polic[y]." *Pireno*, 458 U.S. at 130.

To be sure, the Ohio statute affects the risk that a policyholder's future claims will be paid in the event the insurance company becomes insolvent. But virtually all government regulation of insurance companies has some impact on a policyholder's risk of nonpayment. For example, regulation of the cost-cutting measures at issue in *Royal Drug*, and the peer review system at issue in *Pireno*, affected insurer costs, and therefore the risk that the insurer would be unable to pay claims. As the Court noted in *Royal Drug*, "[m]any aspects of insurance companies are regulated by state law, but are not the 'business of insurance.'" 440 U.S. at 230 n.38 (citing as examples "how [insurance companies] could invest their funds, *when they could liquidate* or merge, as well as how they could purchase goods and services") (emphasis added).

b. Nor is the Ohio priority statute integral to the contractual relationship between the insurance com-

pany and the insured. The Ohio statute is obviously distinct from the contract of insurance itself. Moreover, the Ohio statute does not address the relationship between the insurance company and the insured, but rather the relationship between policyholders and other creditors of insolvent insurance companies. Accordingly, the Ohio statute is properly viewed as one of many state laws applicable to insurance companies that are not integral to the contractual relationship even though the law may affect the probability that future policyholder claims will be paid.

c. Finally, the Ohio priority statute plainly is not limited to entities in the insurance industry. As the court of appeals recognized (App., *infra*, 23a), the Ohio statute applies to *all* creditors of insolvent insurance companies, including general business creditors, employees, and the government. The court of appeals nevertheless concluded that the statute is limited to entities in the insurance industry because it "focus[es]" on the protection of policyholders. In fact, the Ohio statute does not focus exclusively on the protection of policyholders, since it ranks two classes of claims (administrative expenses and wages) ahead of policyholder claims. In any event, the relevant question is not whether the statute "focus[es]" on policyholders, but whether it is part of the "business of insurance." For the reasons set out above, it is not.

4. The court of appeals' decision is also inconsistent with the purpose and legislative history of the McCarran-Ferguson Act. Congress passed the Act in 1945 in response to *United States* v. *South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944), which held that insurance transactions are subject to federal regulation under the Commerce Clause. The Act was "an attempt to turn back the clock" to pre-*South-Eastern*

Underwriters days. *National Securities*, 393 U.S. at 459. In *United States* v. *Knott*, 298 U.S. 544 (1936), a pre-McCarran Act case, the Court held that the federal insolvency statute applied in state court proceedings to liquidate an insolvent insurance company and preempted a state statute that provided for repayment of in-state creditors ahead of all other creditors. Nothing in the language or legislative history of the McCarran-Ferguson Act suggests that Congress intended to alter that result.

More generally, "[t]he primary concern of Congress in the wake of [*South-Eastern Underwriters*] was in enacting legislation that would ensure that the States would continue to have the ability to tax and regulate the business of insurance." *Royal Drug*, 440 U.S. at 217-218. As the Court explained, "[t]he problem was that if insurance was interstate commerce, then the constitutionality of state regulation and taxation would be questionable." *Id.* at 218 n.16 (citing S. Rep. No. 20, 79th Cong., 1st Sess. 2 (1945); H.R. Rep. No. 143, 79th Cong., 1st Sess. (1945)). Here, there is no danger that Ohio will be unable to regulate the liquidation of insolvent insurance companies. The question is simply whether the federal priority statute preempts the state priority statute as to claims of the United States.[4]

---

[4] "A secondary concern" of Congress in enacting the McCarran-Ferguson Act "was the applicability of the antitrust laws to the insurance industry." *Royal Drug*, 440 U.S. at 218. The antitrust exemption was directed primarily at cooperative ratemaking "[b]ecause of the widespread view that it is very difficult to underwrite risks in an informed and responsible way without intra-industry cooperation." *Id.* at 221. See also *Pireno*, 458 U.S. at 133. Neither the antitrust laws nor cooperative ratemaking are at issue here.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

KENNETH W. STARR
Solicitor General

STUART M. GERSON
Assistant Attorney General

MAUREEN E. MAHONEY
Deputy Solicitor General

ROBERT A. LONG, JR.
Assistant to the Solicitor General

WILLIAM G. KANTER
JENNIFER H. ZACKS
Attorneys

MARCH 1992

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 90-3364

GEORGE FABE, Superintendent of Insurance, State of Ohio, PLAINTIFF-APPELLANT

v.

UNITED STATES DEPARTMENT OF THE TREASURY; MITCHELL A. LEVINE, Assistant Commissioner, DEFENDANTS-APPELLEES

On Appeal from the United States District Court for the Southern District of Ohio

Decided and Filed July 17, 1991

Before: MARTIN and JONES, Circuit Judges; and EDGAR, District Judge.*

BOYCE F. MARTIN JR., Circuit Judge. In this declaratory judgment action, the district court found that certain claims of the United States against an insolvent Ohio insurance company are entitled to priority as provided by 31 U.S.C. § 3713 (1988), notwithstanding contrary provisions of Ohio law. Be-

* The Honorable R. Allen Edgar, United States District Judge for the Eastern District of Tennessee, sitting by designation.

cause we find the Ohio insurance liquidation priority scheme at issue to be a regulation of the "business of insurance" within the meaning of the McCarran-Ferguson Act, 15 U.S.C. § 1012(b) (1988), and thus subject solely to the provisions of state law absent explicitly conflicting federal legislation, we reverse.

The facts of this case are uncontested. On April 30, 1986, the Court of Common Pleas for Franklin County, Ohio declared the American Druggists' Insurance Company insolvent. Pursuant to Ohio Rev. Code § 3903, the court directed that American Druggists' be liquidated and appointed George Fabe, the Superintendent of Insurance for the State of Ohio, to serve as liquidator.

The United States filed claims in the liquidation proceedings as obligee on various immigration, appearance, performance and payment bonds issued by American Druggists' as surety. The United States notified Fabe on August 28, 1986, that it would seek first priority for its claims by virtue of the federal superpriority statute, 31 U.S.C. § 3713(a)(1)(A).[1] Thereafter, Fabe filed for a declaratory judgment in federal district court arguing that the federal superpriority statute does not apply to Ohio's liquidation

---

[1] 31 U.S.C. § 3713 provides, in pertinent part:

(a) (1) A claim of the United States shall be paid first when-

(A) a person indebted to the Government is insolvent and-

(i) a debtor without enough property to pay all debts makes a voluntary assignment of property;

(ii) property of the debtor, if absent, is attached; or

(iii) an act of bankruptcy is committed[.]

of American Druggists' because the controlling state priority statute, Ohio Rev. Code § 3903.42, is a regulation of the "business of insurance" within the meaning of the McCarran-Ferguson Act. Accordingly, Fabe argues that § 3903.42 takes precedence over the federal statute, entitling the United States to the lesser priority afforded by state law.

Before the district court, both parties stipulated that Ohio Rev. Code § 3903.42 is a state law which regulates the insurance industry, that application of the federal priority statute would "invalidate, impair, or supercede" the state statute, and that the federal priority statute is not an act which specifically relates to the "business of insurance." *See* McCarran-Ferguson Act, 15 U.S.C. § 1012(b). Therefore, the sole issue presented to both the district court and this court on appeal is whether the Ohio insurance liquidation priority statute is a state law regulating the "business of insurance" within the meaning of the McCarran-Ferguson Act. After a thorough review of relevant precedent, the district court entered judgment for the United States, concluding that Ohio Rev. Code § 3903.42 regulates only the business of insurance companies, not the "business of insurance." *See Securities & Exchange Commission v. National Securities*, 393 U.S. 453, 460 (1969). As a pure question of law, we consider this issue on appellate review independent of the district court's decision. *Salve Regina College v. Russell*, 111 S. Ct. 1217 (1991).

Prior to 1944 the authority to regulate insurance transactions rested exclusively with the several states. *National Securities*, 393 U.S. at 458 (citing *Paul v. Virginia*, 75 U.S. (8 Wall) 168, 183 (1869) (insurance transactions not considered "commerce")). That relationship changed following the Supreme

Court's conclusion in *United States v. South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944), that insurance transactions are commerce, subject to federal regulation under the Commerce Clause. Because Congress feared injury to the traditional policy of state regulation of the insurance industry, it quickly responded.

Declaring that "the continued regulation and taxation by the several States of the business of insurance is in the public interest[,]" 59 Stat. 33, 15 U.S.C. § 1011, Congress passed the McCarran-Ferguson Act, 15 U.S.C. § 1012, to protect the dominion of the states over the "existing and future . . . systems for regulating and taxing the business of insurance." *Prudential Insurance Co. v. Benjamin*, 328 U.S. 408, 429 (1946). The Act provides:

> (a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.
>
> (b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance[.] [2]

15 U.S.C. § 1012. Although the Act exempts from federal preemption only those state regulations which concern the "business of insurance," neither the Act nor its legislative history is particularly enlightening

[2] Several congressional enactments, including the Sherman Act, Clayton Act, and Federal Trade Commission Act, have been amended pursuant to McCarran-Ferguson to provide for continuing federal dominance in areas of national concern. The federal superpriority statute has not been so amended.

as to the meaning of that term. *National Securities*, 393 U.S. at 459. Accordingly, we turn to the Supreme Court's trilogy of cases construing the "business of insurance" to determine whether that term encompasses the Ohio statute.

The first of these three cases interpreting the "business of insurance" under the McCarran-Ferguson Act is *Securities & Exchange Commission v. National Securities*, *id.* at 453. In *National Securities* the Court confronted the issue of whether the Securities & Exchange Commission had the power to regulate the activities of persons engaged in the insurance business. Spesifically, the case focused on an Arizona insurance company which made a number of misrepresentations to shareholders in an attempt to secure their approval for a pending merger. The company sought to avoid prosecution for federal securities violations on the grounds that an Arizona staute aimed at protecting stockholders in domestic insurance companies regulated the "business of insurance," and thus superceded the federal securities act by operation of McCarran-Ferguson. The Supreme Court disagreed.

The Court determined that the Arizona statute was not protected from federal preemption by McCarran-Ferguson because the Act applied only to laws regulating the "business of insurance," not the business of insurance companies. *Id.* at 459. The Court stated:

> Congress was concerned with the type of state regulation that centers around the contract of insurance, the transaction which *Paul v. Virginia* held was not "commerce." The relationship between insurer and insured, the type of policy which could be issued, its reliability, interpretation, and enforcement—these were the core of

> the "business of insurance." Undoubtedly, other activities of insurance companies relate so closely to their status as reliable insurers that they too must be placed in the same class. But whatever the exact scope of the statutory term, it is clear where the focus was—it was on the relationship between the insurance company and the policyholder. Statutes aimed at protecting this relationship, directly or indirectly, are laws regulating the "business of insurance."

Id. at 460. Because the Arizona statute regulated the relationship between shareholder and corporation, rather than insured and insurer, it "is not insurance regulation, but securities regulation[,]" unprotected by McCarran-Ferguson. *Id.* That the Arizona statute applied exclusively to insurance companies is irrelevant:

> The crucial point is that here the State has focused its attention on stockholder protection; it is not attempting to secure the interests of those purchasing insurance policies. Such regulation is not within the scope of the McCarran-Ferguson Act.

Id.

The Court was next called upon to construe the meaning of "business of insurance" in *Group Life & Health Insurance Company v. Royal Drug Company*, 440 U.S. 205 (1979). In *Royal Drug* the Court considered whether alleged anticompetitive agreements between an insurance company and several pharmacies were exempt from the federal antitrust laws. Group Life had entered into agreements with certain pharmacies under which those pharmacies agreed to furnish the insurer's policyholders with prescription

drugs at the price of two dollars per prescription, while Group Life agreed to reimburse the participating pharmacies for their costs in acquiring the prescription drugs sold. Other non-participating pharmacies sued claiming that such agreements violated the Sherman Antitrust Act by fixing the retail price of drugs and by deterring policyholders from dealing with independent retailers. Group Life argued that the agreements were exempt from the antitrust laws as the "business of insurance" regulated by Texas law. Again the Supreme Court disagreed.

The Court began its analysis by noting that central to the definition of the "business of insurance" are "the spreading and underwriting of a policyholder's risk . . . [and] the contract between the insurer and the insured." *Id.* at 211, 215. It found the provider agreements at issue served neither goal. The agreements acted simply as separate contractual arrangements for the purchase of goods and services between the insurer and a third party which furnished the insurer with a substantial cost savings. *Id.* at 216. They did not, as Group Life argued, affect the " 'reliability, interpretation, and enforcement' of the insurance contract [or] 'relate so closely to their status as reliable insurers' as to fall within the exempted area." *Id.* To equate cost effectiveness with reliability would be to distort the notion of the "business of insurance" to such a degree that any business decision made by an insurance company to maximize profits and minimize costs would qualify for exemption.

The Court concluded by suggesting that the provider agreements were not made the business of insurance simply because they were subject to state regula-

tion at the time McCarran-Ferguson was enacted. *Id.* at 230 n. 38.

> [T]he enabling statutes in existence at the time the Act was enacted typically regulated such diverse aspects of the plans as the composition of their boards of directors, when their books and records could be inspected, how they could invest their funds, *when they could liquidate* or merge, as well as how they could purchase goods and services by entering into provider agreements.
>
> Provider agreements are no more the "business of insurance" because they were regulated by state law at the time of the McCarran-Ferguson Act than are these other facets of the plans which were similarly regulated.

Id. (emphasis added). Accordingly, the Court found the purpose of McCarran-Ferguson was not to restore the law to the status quo prior to *South-Eastern*, but to protect state regulation only of the "business of insurance." *Id.* at 230.

The Court's most recent opinion concerning the "business of insurance" is *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982). Pireno was a chiropractic practitioner who challenged Union Labor Life's use of a chiropractic peer review committee to make non-binding recommendations as to whether policyholder claims were "reasonable charges" for "necessary medical care and services," and therefore payable within the coverage limits of the insureds' policies. *Id.* at 122. Pireno's methods were criticized by the committee which recommended that Union Labor Life not pay claims arising from his treatment because both the number of prescribed visits and the cost per treatment were excessive. Pireno sued

claiming Union Labor Life's use of the peer review committee was a conspiracy to fix prices and restrain competition in violation of the Sherman Act. The district court granted summary judgment to Union Labor Life on the grounds that use of the peer review committee provided an efficient means of determining the company's obligation in the claims adjustment process, and so was protected from antitrust scrutiny by the McCarran-Ferguson Act. Again, the Supreme Court disagreed.

The Court reviewed its prior decisions and identified a three-part test for determining whether certain conduct is part of the "business of insurance."

> [*F*]*irst,* whether the practice has the effect of transferring or spreading a policyholder's risk; *second,* whether the practice is an integral part of the policy relationship between the insurer and the insured; and *third,* whether the practice is limited to entities within the insurance industry. None of these criteria is necessarily determinate in itself. . . .

Id. at 129. Applying this test, the Court found the agreement between Union Labor Life and the peer review committee to fail each of the three prongs.

The Court first rejected Union Labor Life's argument that the peer review activity was within the "business of insurance" because it aided the insurer in determining the scope of the risk transferred. The Court found the foundation of this argument, that risks were transferred upon payment, to be contrary to the fundamental tenets of insurance: "The transfer of risk from insured to insurer is effected by means of the contract between the parties-the insurance policy-and that transfer is complete at the time that

contract is entered." *Id.* at 130; *See* 9 G. Couch, Cyclopedia of Insurance Law §§ 39.53; 39:63 (2d ed. 1962). Though the Court did find the actual claims adjustment process to be within the "business of insurance," the non-binding nature of the committee's recommendations removed it so far from the policy relationship that it could not be said to be central to the risks spread at the time of contracting. *Id.* at 134 n.8.

In addressing the second criterion, the Court found it clear that the peer review system was not "an integral part of the policy relationship between insurer and insured." *Id.* at 131. Like the provider agreements at issue in *Royal Drug*, the arrangement between Union Labor Life and the peer review committee was a separate and distinct contract between the insurer and a third party non-insurer, with only ancillary impact upon the contract of insurance. Such arrangements are not the "business of insurance," but merely cost savings devices which are immaterial to the policyholder whose only concern is that his claim be paid, not why it is paid. *Id.* at 132.

The Court also had little difficulty finding that the challenged peer review activities were not "limited to entities within the insurance industry," because the very nature of the agreement at issue implicated the substantial and direct involvement of third party non-insurers. *Id.* Though "the challenged peer review practices need not be denied the [McCarran-Ferguson] § 2(b) exemption solely because they involve parties outside the insurance industry[,]" it is clear that such third party arrangements which have only an ancillary effect on policy holders were not at the core of Congressional concern during the passage of the McCarran-Ferguson Act. *Id.* at 133. Accordingly, the peer review agreements are subject to the provisions of the Sherman Act, because they do not regulate the "business of insurance."

Though *Pireno* is the latest case addressing the meaning of the "business of insurance," its analysis is but a distillation of the earlier cases. We disagree with Fabe's assertion here that *Pireno* and *Royal Drug* are limited to antitrust exemption; given the Supreme Court's use of the *Pireno* analysis in other contexts, we find that argument to be untenable. *See Metropolitan Life Ins. Co. v. Massachusetts*, 471 U.S. 724, 742-44 (1985) (applying *Pireno* test to define "business of insurance" under ERISA savings clause); *Pilot Life Ins. Co. v. Dedeaux*, 481 U.S. 41, 50-51 (1987) (same). Rather, we find *National Securities* and *Royal Drug* to be of continuing instructive value in the application of *Pireno*. Accordingly, our review of Ohio Rev. Code § 3903.42 will draw from each of these opinions.

The state regulation at issue in this case, Ohio Rev. Code § 3903.42, is part and parcel of a large, complex and specialized administrative system adopted by the State of Ohio to regulate the life of domestic insurance companies from incorporation to dissolution pursuant to McCarran-Ferguson. Ohio Rev. Code § 3901 *et seq.* Chapter 3903 provides a comprehensive scheme for the orderly supervision, rehabilitation, and/or liquidation of Ohio insurance companies. *American Centennial Insurance Corp. v. ARMCO, Inc.*, 746 F. Supp. 350 (S.D.N.Y. 1990). Such regulation is critical to the protection of the insurance consumer because insurance companies are not subject to subrogation in bankruptcy proceedings under chapters seven or eleven of the Federal Bankruptcy Code. 11 U.S.C. § 109 (1979). For this reason, fed-

eral courts have often abstained from considering questions regarding state liquidation proceedings in order to protect the state's substantial interests in this regard. *See, e.g., Grimes v. Crown Life Ins. Co.*, 857 F.2d 699 (10th Cir. 1988), *cert. denied*, 489 U.S. 1096 (1989); *United Services Auto Ass'n v. Muir*, 792 F.2d 356 (3d Cir. 1986), *cert. denied sub nom. Grode v. United Services Auto. Ass'n*, 479 U.S. 1031 (1987); *Levy v. Lewis*, 635 F.2d 960 (2d Cir. 1980); *Washburn v. Corcoran*, 643 F. Supp. 554 (S.D.N.Y. 1986). Of course, abstention is inappropriate in this case which presents a direct federal question.

The stated purpose of Chapter 3903 is to provide a coherent policy for the liquidation of insurers for "the protection of the interests of insureds, creditors, and the public generally. . . ." Ohio Rev. Code § 3903.02(D). The district court provided an adequate synopsis of its pertinent provisions:

> The Superintendent of Insurance may file a complaint seeking an order to liquidate an insurer for one of a number of reasons, Ohio Rev. Code § 3903.17, and if the Court of Common Pleas issues an order to liquidate[,] the superintendent is appointed as liquidator and is directed to liquidate the company. Ohio Rev. Code § 3903.18 (A). Within such liquidation Ohio Rev. Code § 3903.43 establishes the priorities for payment of claims.

Under § 3903.42, all claims against the liquidated insurance company are placed into classes and prioritized. All claims in each class are to be paid in full before members of subordinate classes may receive any payment. Classes one and two contain the usual provisions for the costs and expenses of administering

the scheme, and compensating employees for services performed and benefits accrued. Class three includes "all claims under policies for losses incurred," including policyholders who seek to recover their investments. Class four is limited to the claims of general creditors. Class five provides for any claims filed by federal, state, or local governments.

In the present case, American Druggists' was liquidated pursuant to the Ohio scheme. The United States filed claims in the insolvency proceedings as obligee on various general obligation surety bonds defaulted by American Druggists'. This case does not involve federal claims for taxes due, but merely federal claims against a defaulted surety in which the United States stands in the same position as other bond obligees. However, the United States asserts that, pursuant to the federal superpriority statute, it may leapfrog the claims of other policyholders solely because it is the United States. That argument turns on whether the Ohio liquidation priority statute regulates the "business of insurance."

Before turning our attention to those cases which have considered the issue of whether such priority schemes may be considered a regulation of the "business of insurance," we must address two arguments made by the United States which it argues are dispositive. The United States first contends that the issue before us was settled by the Supreme Court's 1936 opinion in *United States v. Knott*, 298 U.S. 544. It argues that because McCarran-Ferguson "was an attempt to turn back the clock," the Supreme Court's pre-McCarran holding in *Knott*, that a Florida insurance priority law was subject to federal preemption, controls the outcome of the case before us. We disagree with this assertion on two grounds. First,

McCarran-Ferguson did not return to the *status quo* prior to *South-Eastern Underwriters*; instead, it only permitted state regulation of the "business of insurance," without federal interference. *Royal Drug*, 440 U.S. at 220 n. 24. Second, even if it had, the Florida statute at issue in *Knott* contained only generalized provisions protecting domestic creditors in Florida insurance companies over foreign creditors; it in no way regulated the "business of the insurance" for the protection of the insured. *See National Securities*, 393 U.S. at 460 (where focus is away from the protection of insureds statute does not regulate the "business of insurance").

The United States' second conclusory argument is that footnote 38 of *Royal Drug*, 440 U.S. at 230, forecloses plaintiff's claim by listing among those statutes that do not regulate the business of insurance rules that concern *when* insurance companies may liquidate. We cannot agree with the implicit foundation of this argument, that any regulation of insurance liquidation is *per se* not a regulation of the "business of insurance." Rather, we find the better approach to be an independent assessment as to whether each facet of a challenged plan regulates the "business of insurance" under the *Pireno/Royal Drug/National Securities* trilogy.

As the parties have stipulated, it is beyond doubt that the provisions of the federal superpriority statute, 31 U.S.C. § 3713, are in direct conflict with Ohio Rev. Code § 3903.42. However, because the federal statute does not explicitly supercede McCarran-Ferguson, the state statute controls unless it was not enacted for the purpose of regulating the "business of insurance." Those courts that have considered whether an insurance liquidation priority statute may be considered a regulation of the "business of insurance" are split.

Only two federal circuit courts have addressed the precise question raised in this appeal, *State of Idaho ex rel. Soward v. United States*, 858 F.2d 445 (9th Cir. 1988, *cert. denied sub nom. Fagiano v. United States*, 109 S. Ct. 2063 (1989) and *Gordon v. United States Dep't of the Treasury*, 668 F. Supp. 483 (D. Md. 1987), *aff'd*, 846 F.2d 272 (4th Cir.), *cert. denied*, 109 S. Ct. 390 (1988). Both rejected the argument that the liquidation priority statutes before them regulated the "business of insurance," though on divergent grounds. Other courts have considered the issue as an ancillary matter and have come to a different conclusion. *Grimes*, 857 F.2d at 704; *Muir*, 792 F.2d at 364; *Levy*, 635 F.2d at 965; *Washburn*, 643 F. Supp. at 556. Because each case makes fundamental assumptions as to the nature of the "business of insurance" within the *Pireno/Royal Drug/National Securities* line of cases, we shall review the major decisions to facilitate our analysis.

The first case to squarely address the issue, *Gordon v. United States Dep't of the Treasury*, 846 F.2d at 272, demonstrates some of the controversies surrounding the *Pireno* analysis. *Gordon* involved a Maryland insurance liquidation priority statute which placed government claims at the same level with those of policyholders. *Gordon*, 668 F. Supp. at 486. The United States asserted priority status in the liquidation proceedings of a Maryland insurer under 31 U.S.C. § 3713. As State Superintendent of Insurance, Gordon sued claiming that giving priority to federal claims would invalidate a state law regulating the "business of insurance" in violation of McCarran-Ferguson.

The Maryland district court's opinion, which was adopted by the Fourth Circuit, applied the *Pireno*

analysis and found McCarran-Ferguson inapplicable to the Maryland statute. The court rejected the abstention cases proffered by the Maryland Insurance Commission as authority that such statutes do regulate the "business of insurance" because none had applied the *Pireno* test. *Id.* at 489 n. 8. Stating, "[t]he risk that an insurance company will become insolvent . . . is not the type of risk transfer emphasized in *Pireno* and *Royal Drug*[,]" the court found the liquidation statute failed the first prong of the *Pireno* test, whether the challenged statute facilities the transfer or spread of risk. More importantly, the court stated that summary judgment for the United States could be made on this basis alone because the first prong is "indispensable,"[3] *id.* at 490-91; although the court concluded by stating with little elaboration that neither of the other *Pireno* prongs were satisfied.

The Ninth Circuit addressed the question before us in *State of Idaho Ex Rel. Soward v. United States*, 858 F.2d 445 (9th Cir. 1988). *Soward* involved an Idaho liquidation priority statute, Idaho Code § 41-3342, which is nearly identical to Ohio Rev. Code § 3903.42. The Director of the Department of Insurance for the State of Idaho sought judgment declaring that the state liquidation scheme prevailed over the federal superpriority statute because it was a regulation of the "business of insurance" under McCarran-Ferguson.

The Idaho district court agreed. *Soward*, 662 F. Supp. 60 (1987). The court found the liquidation priority scheme to be part of a larger administrative

[3] The Fourth Circuit refused to consider the propriety of the district court's characterization of prong one as "indispensable." 846 F.2d at 274.

system for regulating of the entire life of domestic insurance companies. Relying on the abstention case of *Washburn v. Corcoran*, 643 F. Supp. at 554 (laws concerning winding up of insurance companies regulates the "business of insurance"), the court concluded that laws providing for the rehabilitation, liquidation or dissolution of insurance companies are laws regulating the "business of insurance" exempt from federal legislation because, "[t]he right of the state to regulate and control the insurance company should include the right to manage its dissolution and liquidation as part of the overall regulatory scheme." *Soward*, 662 F. Supp. at 63. However, the district court did not apply the *Pireno* analysis.

On appeal, the Ninth Circuit reversed. *Soward*, 858 F.2d at 445. The court analyzed the liquidation priority statute under the *National Securities* definition of "business of insurance," stating

> Although ostensibly appearing to speak to the precise issue raised here, neither *Royal Drug* nor *Pireno* are necessary to decide this case. Both cases are refinements of the seminal analysis of *National Securities* tailored to address activities of insurance companies that would implicate the antitrust laws in the absence of the McCarran-Ferguson Act.

Id. at 452. The court found that the Idaho statute did not affect "the type of policy which could be issued, its reliability, interpretation, and enforcement" or protect the "relationship [of insured and insurer], directly or indirectly," because the regulation applies only to companies that are no longer in the business of insurance. *Id.* at 452 (quoting *National Securities*, 393 U.S. at 460.) Therefore, the court concluded the only relationship regulated by Idaho is that of debtor

and creditor, a relationship that is not protected by McCarran-Ferguson.[4] *Soward*, 858 at 452.

Although both the Fourth and Ninth Circuits have rejected the theory of Fabe's claim, he is not without authority for his position. A number of courts have abstained from exercising federal jurisdiction in cases involving state insurance liquidation priority schemes on McCarran-Ferguson grounds. *See, e.g., Grimes*, 857 F.2d at 699 (court abstains declaring receivorship regulations are laws concerning the "business of insurance"); *Levy*, 635 F.2d at 960 (court abstains in case involving conflict between state insurance liquidation statute and ERISA); *Washburn*, 643 F. Supp. at 554 (court abstains in conflict between Federal Arbitration Act and New York law regulating the liquidation of domestic insurance companies). These courts have determined that federal intervention into the complex administrative schemes developed by the states for the winding up of defaulting insurance companies risks damaging the delicate balance struck by state legislatures, who, acting pursuant to federal policy, are attempting to regulate a portion of the business of insurance which necessarily involves the adjustment of thousands of claims by policyholders against domestic insurers. *Washburn*, 643 F. Supp. at 556.

Though most of the abstention cases cited by plaintiff are weakened by their failure to apply the *Pireno* analysis, we do find these cases to be persuasive as to whether state regulation of insurance company insolvency and rehabilitation constitutes the regulation of the "business of insurance" within the meaning of

[4] In dicta the court indicated that if it were to apply the *Pireno* test the liquidation priority would fail on similar grounds.

the McCarran-Ferguson Act. One case, however, *United Services Auto. Ass'n v. Muir*, 792 F.2d at 365, does discuss the effect of the *Pireno* paradigm on insurance liquidation priority statutes. In *Muir*, a domestic insurer sought to enjoin the state insurance commission from revoking its license to sell insurance for its violation of a state regulation prohibiting mergers between insurers and financial institutions. *Id.* at 359-60. Relying on *Levy*, 635 F.2d at 960, the district court found that abstention was appropriate because the statute at issue was one regulating the "business of insurance" under McCarran-Ferguson, over which the states have exclusive control. *Id.* at 364.

The Third Circuit reversed. Applying *Pireno*, the court found abstention inappropriate because the anti-merger provision did not implicate the "business of insurance." However, the court distinguished its holding from those abstention cases involving insurance liquidation proceedings, which it felt met the *Pireno* standard.

> The state regulations implicated in *Levy* concerned both the future coverage of policyholders and their relationship with a defunct insurer, and so were authorized under McCarran-Ferguson. . . . Unlike the regulations in *Levy*, the [merger] section is not concerned with transferring or spreading the policyholder's risk; [the merger section] has no integral connection to the relationship between the insured and insurer; and [the merger section involves groups that are] not entities within the insurance industry.

Id. at 364.

As our discussion has developed, we are confronted with a confusing mass of interpretations as to the

term "business of insurance" which leaves basic, fundamental questions unanswered. Our starting point is the recognition that "[i]n the absence of the type of comprehensive federal regulation over insurance accorded the banking, securities and commodities industries, and because of the exclusion of insurance companies from the operation of federal bankruptcy law, 11 U.S.C. § 109, the states have assumed the primary role in regulating insurance," under the provisions of the McCarran-Ferguson Act. *Lac D'Amiante du Quebec v. American Home Assurance Company*, 864 F.2d 1033, 1039 (3d Cir. 1988). Accordingly, states have adopted a variety of regulatory mechanisms.

> [t]he emphasis [of which has] been placed simply upon protecting the little policy-holder who cannot tell when he is charged too much for his insurance; since he does not investigate his purchase too carefully nor could he determine if a given insurer has the capacity, i.e. the solvency, to perform in the future when the insured event occurs, the States have established regulatory bodies to secure that necessary measure of protection.

Richards, *Insurance*, at 39. Thus if we apply a test of logic, Ohio Rev. Code § 3903.42 is a state regulation which protects the interests of the insured, and therefore is protected from federal preemption as a law regulating the "business of insurance." Accordingly, the United States, as bond obligee, is not permitted to supercede the claims of superior creditors.

We find nothing in *Pireno* to suggest that its three part test should not be applied in the present case. Ohio Rev. Code § 3903.42 fulfills the *Pireno* require-

ments because it (1) transfers the policyholders risk of loss by insolvency at the time of contracting, (2) is an integral part of the relationship between insurer and insured, and (3) is exclusive in its operation to entities within the insurance industry.

Section 3903.42 has the effect of transferring and spreading a policy holder's risk that his insurer will become insolvent. By transferring that risk from the policyholder to the illiquid insurer or its appointed receiver and spreading that risk among all those policyholders and non-policyholders who are entitled to a statutorily specified priority, § 3903.42 meets the first prong of the *Pireno* analysis.

The United States argues that § 3903.42 does not spread or transfer a policyholder's risk at the time of contract, but merely provides a means of payment after the insured event occurs, and therefore is insufficient under *Pireno*, 458 U.S. at 130. We disagree. The provisions of § 3903.42 are exclusive in their operation and furnish a complete procedure for the protection of the rights of all parties involved, including policyholders with claims for covered losses, and policyholders who seek to recoup their investments. Ohio Rev. Code 3903.42(C). Accordingly, we find § 3903.42 is designed to support and undergird the entire contractual process between insurer and insured, as implicitly recognized by the parties, by transferring the risk of insolvency immediately upon contacting. Just as the regulatory scheme of the Federal Depositor Insurance Corporation regulates the business of banking for the protection of depositors, § 3903.42 regulates the business of insurance for the protection of policyholders. We feel the risk safeguarded against by such a statute is suffi-

cient to qualify under *Pireno* for protection from federal preemption.

Although § 3903.42 transfers an insured's risk at the time of contracting, we cannot agree that this finding alone is sufficient to support a judgment for Fabe. *Pireno*, 458 U.S. at 129; *Cf. Gordon*, 688 F. Supp. at 490-91. The second *Pireno criteria* must also be met: whether the regulation at issue is an integral part of the policy relationship between insurer and insured. Unlike *National Securities, Royal Drug*, and *Pireno*, this case does not involve a third-party non-insurer seeking to avoid the provisions of federal law through the operation of the McCarran-Ferguson Act. Rather, it concerns a state law designed to protect the interests of insureds in their relationship with insurers by providing assurances as to the reliability and enforcement of the policies issued. *See National Securities*, 393 U.S. at 460.

The United States asserts that § 3903.42 has no impact upon the policy relationship because it applies only to insolvent insurers no longer in the "business of insurance." *See Soward*, 858 F.2d at 452. We find this argument to misunderstand the nature of an insolvent insurer. Once an insurer is placed in receivership, only the sale of new policies is suspended during liquidation; the actual adjustment of claims and the payment of existing claims continue. The continuation of these activities, central to the "business of insurance," forecloses the United States' argument. *Pireno*, 458 U.S. at 134 n.8. Accordingly, because of its direct and substantial impact upon the policyholder, we find § 3903.42 constitutes an integral part of the policy relationship between insurer and the insured, satisfying the second prong of *Pireno*.

Finally, we fined that § 3903.42 satisfies the third prong of *Pireno* because the priority scheme, by its

own terms, is limited to entities within the insurance industry. Although the liquidation of an insurance company necessarily involves the claims of non-policied creditors, it is clear from the language and operation of § 3903.42 that its focus is the protection of in-insureds by diverting the scarce resources of the liquidated entity away from any non-insured creditors, toward policyholders. *See National Securities*, 393 U.S. at 460 (involvement of entities outside insurance industry impermissible where goal of regulation is not the protection of policyholders). The insurance liquidation priority scheme "need not be denied the § 2(b) exemption solely because" it also determines the rights of other non-policyholders. *Pireno*, 458 U.S. at 133.

Because we find Ohio Rev. Code § 3903.42 satisfies all three prongs of the *Pireno* analysis, it is exempt from federal preemption as a regulation of the "business of insurance" within the McCarran-Ferguson Act. The judgment of the district court is reversed and the case is remanded for entry of judgment in favor of the liquidation of American Druggists' Insurance Company pursuant to Ohio law.

EDGAR, District Judge, concurring:

I concur that the application of the three-part *Pireno* test to Ohio Rev. Code § 3903.42 requires that it not be superseded by the federal superpriority statute, 31 U.S.C. § 3713(a)(1)(A). I also believe that the result reached by Judge Martin is compelled for other reasons.

The states have always presided over the liquidation of insolvent companies. The states did this for many years prior to the Supreme Court's decision in *United States v. South-Eastern Underwriters Ass'n*,

322 U.S. 533 (1944). *See Motlow v. Southern Holding & Securities Corp.*, 95 F.2d 721, 725-26 (8th Cir.), *cert. denied*, 305 U.S. 609 (1938); *In re Peoria Life Ins. Co.*, 75 F.2d 777, 778 (7th Cir.), *cert. denied*, 296 U.S. 594 (1935). The states have continued to play this role. The federal Bankruptcy Code has never attempted to invade the province of the states in handling the liquidation of insurance companies.

Although Judge Martin has reached a different conclusion, I believe the purpose of the McCarran-Ferguson was to restore the law to its status prior to *South-Eastern Underwriters*. As Justice Stewart said in *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205 (1979), "There is no question that the *primary* purpose of the McCarran-Ferguson Act was to preserve state regulation of the activities of insurance companies, as it existed before the *South-Eastern Underwriters* case." 440 U.S. at 218 n. 18 (emphasis in original). *See Securities and Exchange Comm'n v. National Securities, Inc.*, 393 U.S. 453, 459 (1969). It may reasonably be inferred, therefore, that Congress intended that long standing, traditional state regulation of insurance company liquidations continue unmodified by federal statute after the enactment of McCarran-Ferguson. Certainly there is no language in either McCarran-Ferguson or the federal superpriority statute which indicates otherwise.

In *National Securities* the "business of insurance," which was re-subjected to state regulation by McCarran-Ferguson, was described by the Supreme Court as follows:

> Congress was concerned with the type of state regulation that centers around the contract of

> insurance, the transaction which *Paul v. Virginia*[, 75 U.S. 168 (1869),]held was not "commerce." The relationship between insurer and insured, the type of policy which could be issued, its *reliability*, interpretation, and *enforcement*—these were the core of the "business of insurance." Undoubtedly, other activities of insurance companies relate so closely to their status as reliable insurers that they too must be placed in the same class. But whatever the exact scope of the statutory term, it is clear where the focus was—it was on the relationship between the insurance company and the policyholder. Statutes aimed as protecting or regulating this relationship, directly or indirectly, are laws regulating the "business of insurance."

393 U.S. 453 at 460 (emphasis added).

The Ohio liquidation statute prefers the claims of policyholders over those asserted by the United States government under the superpriority statute. The statute is thus aimed directly at the reliability of insurance policies purchased from Ohio insurance companies and with the enforceability of those policies. Even though the payment and adjustment of claims occur after the insurance company is in the hands of a liquidator, this does not mean that the company is no longer in the "business of insurance." The Ohio statute is quintessentially a state law that relates to the regulation of the business of insurance.

JONES, Circuit Judge, dissenting. The majority correctly phrases the narrow issue presented to us for review as "whether the Ohio insurance liquidation priority statute is a state law regulating the 'business of insurance' within the meaning of the McCarran-

Ferguson Act." Maj. op. at 3. In my view, however, the majority attaches too broad an interpretation to the phrase "the business of insurance", and as a result incorrectly concludes that Ohio's liquidation priority scheme is not subject to federal preemption. Such a holding fails to comport with relevant caselaw from other Courts of Appeals and the U.S. Supreme Court. I respectfully dissent.

Two other Circuits have already addressed the precise issue before us and have persuasively concluded that the liquidation of insolvent insurance companies is not "the business of insurance" within applicable Supreme Court precedent. In both *State of Idaho ex rel. Soward v. United States*, 858 F.2d 445 (9th Cir. 1988), *cert. denied*, 109 S. Ct. 2063 (1989) and *Gordon v. U.S. Dep't of Treasury*, 668 F. Supp. 483 (D.Md. 1987), *aff'd*, 846 F.2d 272 (4th Cir.), *cert. denied*, 109 S. Ct. 390 (1988), as in the instant case, a state's insurance authorities, in its capacity as liquidator or receiver for an insolvent insurance company, challenged the federal government's assertion of priority. In both these cases, directly on point with the instant case, the priority of the federal government's claim was upheld. The majority concedes that the Fourth and Ninth Circuits have explicitly rejected Fabe's theory, yet reaches a directly opposite result based on abstention cases of questionable relevance and pure *ipse dixit.*

The majority emphasizes the scope of the Ohio liquidation statute. However, Ohio's ability to regulate the entire relationship between insurer and insured is not at issue. It is elementary that "[r]eorganization of insolvent insurance companies is a matter of state law and is handled through insolvency proceedings in state court." *Gordon*, 668 F. Supp. at

487. The federal government in this case only argues its priority in Ohio's liquidation of an Ohio insurance company, and does not seek to challenge Ohio's overall authority to regulate.

"[]In determining whether a particular practice is part of the 'business of insurance' ", three factors should be considered: "*first*, whether the practice has the effect of transferring or spreading a policyholder's risk; *second*, whether the practice is an integral part of the policy relationship between the insurer and the insured; and *third*, whether the practice is limited to entities within the insurance industry. None of these criteria is necessarily determinative in itself[.]" *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, 129 (1982). The first prong of the *Pireno* test inquires whether Ohio's liquidation priority statute transfers or spreads a policyholder's risk. *Pireno* stated that "[t]he transfer of risk from insured to insurer is effected by means of the contract between the parties—the insurance policy—and that transfer is complete at the time that the contract is entered." 458 U.S. at 130. It is clear that, under *Pireno*, the transfer of risk has already been effectuated at the liquidation stage; therefore, any prioritization scheme instituted by the state of Ohio to govern liquidation of insurance companies has nothing to do with the transferring or spreading of risk within the meaning of *Pireno*. *See also Soward*, 858 F.2d at 454 ("The statute's assignment of priority to some creditors as against governmental entities does not transfer or spread policyholder risk"); *Gordon*, 846 F.2d at 273 (insurance commissioner's arguments fail to satisfy first prong of *Pireno* test because "the risk of insurer insolvency is certainly qualitatively distinct from the risk the policyholder seeks to transfer in an insurance contract.").

The majority envisions two kinds of risk of loss. First, the policyholder transfers a risk of loss to the insurance company at the time the initial insurance contract is signed. The later transfer of risk of loss occurs at the moment an insurance company is liquidated and Ohio's Superintendent of Insurance is appointed as liquidator. Although Ohio's liquidation priority scheme may be characterized as a transferring a risk of loss to some extent, the ordering of creditors' claims does not effectuate a transfer of risk vis-a-vis the policyholder. The position that the liquidation of an insurance company effects a transfer of risk is directly contradicted by *Pireno*: "The transfer of risk from insured to insurer . . . is complete at the time that the contract is entered." 458 U.S. at 130. The mere fact that Ohio's liquidation priority statute was enacted "for the protection of policyholders", maj. op. at 17, is irrelevant to the issue of whether the priority scheme has the effect of transferring a policyholder's risk under *Pireno*.

The second *Pireno* prong asks us to consider whether Ohio's prioritization statute is an integral part of the policy relationship between the insurer and the insured. The majority answers this inquiry in the affirmative solely because the payment of claims continues after the insurer is placed in receivership. This analysis, however, attributes to the liquidator rights which have already vested by virtue of the initial contract between the insurer and the insured. Simply because the insured's right to receive payment under the initial contract of insurance continues after the insurer is placed in receivership does not indicate to me that the statute at issue is "an integral part of the policy relationship between the [now-defunct] insurer and the insured." 458 U.S.

at 129. The policyholder's rights and responsibilities are still governed by the original contract of insurance entered into with the insured. Rather than playing an integral role in the policy relationship between insurer and insured, Ohio's priority statute instead addresses "the relationship between those left in the lurch by the expiration of the insurer." *Soward*, 858 F.2d at 454. I am persuaded by the reasoning of the district court in *Gordon*, specifically adopted by the Fourth Circuit:

> [N]either the liquidation statute nor the priority statute are an "integral part" of the relationship between the insured and the insurer. The contractual liability to pay on a policy of insurance is obviously distinct from the question of who gets paid first. As with the claims adjustment process described in *Pireno*, the concern is whether a claim is paid, not why it is paid. *Pireno*, 458 U.S. at 132, 102 S. Ct. at 3010. Plaintiff contends that the priority statute does in fact determine whether a policyholder gets paid. The fallacy of plaintiff's argument is in his focus on the sufficiency of assets of the insurance company and its financial ability to pay rather than its liability for risks of loss as embodied in the contract of insurance. Whether the individual policyholder would be entitled to payment was determined when the contract was entered into; that is, when the risk was transferred, and not at the time of payment, if any.

668 F. Supp. at 4[illegible].

Under the third prong of *Pireno*, we must determine whether Ohio's priority statute "is limited to entities within the insurance industry." 458 U.S. at

129. This inquiry is easily resolved because this statute "govern[s] the rights of all creditors, not just policyholders." 668 F. Supp. at 491. "Creditors of all varieties have their claims assigned priorities by the statute, including the local, state, and federal governments." *Soward*, 858 F.2d at 454. The majority initially admits that an insurance company's liquidation encompasses non-policied creditors, but nevertheless finds for plaintiff on this issue because the funds used to pay non-policied creditors may reduce the funds available to pay policyholders. Although ensuring that valid claims of policyholders are paid is an admirable goal, it is not relevant to our inquiry under *Pireno*. Indeed, were we writing on a clean slate I would agree with the majority that the concerns of the policyholders of a liquidated insurance policy should figure prominently in our analysis.[1] However, as a lower court, we are obliged to follow the dictates of the Supreme Court and to eschew broad public policy considerations, especially in this case where constitutional questions of due process or equal protection are not presented. Accordingly, because I believe that applicable law mandates the priority of the federal claim in this liquidation proceeding, I dissent.

---

[1] The majority assertion that "it is clear" that the focus of Ohio's liquidation priority statute "is the protection of insureds", maj. op. at 18, is correct in the sense that Ohio's priority statute prioritizes the claims of policyholders above the claims of general creditors and claims of any federal, state, or local government. Ohio Rev. Code Ann. § 3903.42 (Baldwin 1989). However, there are two categories whose claims take priority over the claims of policyholders: (1) "[t]he costs and expenses of administration", and (2) "[d]ebts due to employees for services performed[.]" *Id.*

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF OHIO
EASTERN DIVISION

Case C-2-88-778

GEORGE FABE, SUPERINTENDENT OF INSURANCE,
PLAINTIFF

vs.

UNITED STATES DEPARTMENT OF THE TREASURY,
ET AL., DEFENDANTS

MEMORANDUM AND ORDER

[Filed Mar. 15, 1990]

On July 26, 1988, plaintiff filed the instant declaratory judgment seeking a determination as to the priority of claims of the United States in the liquidation of an insolvent Ohio insurance company. This matter is presently before the court on cross-motions for summary judgment.

STATEMENT OF FACTS

The facts as set forth in the complaint and admitted in defendants' answer are as follows: Plaintiff George Fabe is the Superintendent of Insurance for the State of Ohio. On April 30, 1986, the Court

of Common Pleas for Franklin County, Ohio issued an order finding American Druggists' Insurance Company (hereinafter "ADIC" to be insolvent. Pursuant to Ohio Revised Code Chapter 3903 the court appointed plaintiff Fabe as liquidator and directed that ADIC be liquidated.

The United States filed claims in the ADIC liquidation based primarily upon "immigration bonds, appearance bonds, and performance and payment bonds." Defendant Mitchell A. Levine, Assistant Commissioner, United States Department of the Treasury, notified plaintiff on August 28, 1986, that the claims of the United States were entitled to first priority in the ADIC liquidation by virtue of 31 U.S.C. § 3713.

Plaintiff alleges 31 U.S.C. § 3713 does not apply to a state's liquidation of an insurance company because of the McCarran-Ferguson Act, 15 U.S.C. § 1011 *et seq.* Accordingly, plaintiff argues that the claims asserted by the United States are not entitled to first priority, but are entitled only to the priority afforded under state law, specifically Ohio Rev. Code § 3904.42. Plaintiff alternatively alleges that the claims arising under the Miller Act, 40 U.S.C. § 270a-d, are not debts to the United States within the meaning of 31 U.S.C. § 3713. Defendant responds that the claims of the United States, which include the Miller Act claims, are entitled to priority in the ADIC liquidation in accordance with 31 U.S.C. § 3713.

DISCUSSION

The parties agree that there are no material facts in dispute and that the issues raised in their respective motions for summary judgment concern only questions of federal and state law.

A. *Priority of Claims of the United States*

The predominant issue in dispute concerns whether the priority to be given to the claims of the United States in the ADIC liquidation is to be determined under federal or state law. Defendant relies on the federal priority statute, 31 U.S.C. § 3713(a), which provides in pertinent part:

> (1) A claim of the United States Government shall be paid first when—
>
> (A) a person indebted to the Government is insolvent and—
>
> (i) the debtor without enough property to pay all debts makes a voluntary assignment of property;
>
> (ii) property of the debtor, if absent, is attached; or
>
> (iii) an act of bankruptcy is committed.

Plaintiff argues that 31 U.S.C. § 3713 does not control because the claims at issue are claims against the assets of an insolvent insurance company being liquidated pursuant to state insurance law. Plaintiff relies on the McCarran-Ferguson Act, 15 U.S.C. § 1012, which provides in pertinent part:

> (a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several states which relate to the regulation or taxation of such business.
>
> (b) No Act of Congress shall be construed to invalidate, impair, or supercede any law enacted by any State for the purpose of regulating the business of insurance, or which

> imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance.

Plaintiff argues that to apply 31 U.S.C. § 3713 and give the claims of the United States first priority in this instance would impair the laws of the state of Ohio enacted to govern the business of insurance. The parties agree that the state laws under which plaintiff proceeds regulate the insurance industry and that the federal priority statute would alter, and thus "invalidate, impair, or supercede" the priority scheme set forth in the state statute. The parties further agree that the federal priority statute is not an act which "specifically relates to the business of insurance." The issue then, as properly framed by the parties, is whether the Ohio statutes regulating the liquidation of insolvent insurance companies are laws regulating the "business of insurance" within the meaning of 15 U.S.C. § 1012(b).

The United States Supreme Court has provided some guidance as to the scope of the term "business of insurance." One of the seminal cases on this subject is *Securities and Exchange Commission v. National Securities, Inc.*, 393 U.S. 453 (1969), in which the Supreme Court held that a state statute aimed at protecting stockholders of insurance companies is not a regulation of the business of insurance. The court reasoned:

> Congress was concerned with the type of state regulation that centers around the contract of insurance, ... The relationship between insurer and insured, the type of policy which could be issued, its reliability, interpretation, and enforcement—these were the core of the "business of insurance." Undoubtedly, other activities of insurance companies relate so closely to their status as reliable insurers that they too must be placed in the same class. But whatever the exact scope of the statutory term, it is clear where the focus was—it was on the relationship between the insurance company and the policyholder. Statutes aimed at protecting or regulating this relationship, directly or indirectly, are laws regulating the "business of insurance."

Id. at 460.

In *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205 (1979), the court considered whether alleged anticompetitive agreements between an insurance company and several pharmacies were exempt from the antitrust laws because they are the "business of insurance" within the meaning of § 2(b) of the McCarran-Ferguson Act (15 U.S.C. § 1012(b)).[1] The court concluded that the agreements at issue were not the business of insurance. Examining the legislative history of 15 U.S.C. § 1012, the court noted that, "References to the meaning of the 'business of insurance' in the legislative history of the McCarran-Ferguson Act strongly suggest that Congress understood the business of insurance to be the underwriting and the

---

[1] The Act, in addition to the language quoted *supra* page 4, further provides:

> That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

spreading of risk." *Id.* at 220-21. The court also indicated that the "business of insurance" is not synonymous with the "business of insurance companies." *Id.* at 211.

The Supreme Court again examined the McCarran-Ferguson Act in the context of antitrust litigation in *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982). In *Pireno* the court discussed at length the analysis set forth in *Royal Drug* and summarized that *Royal Drug* "identified three criteria relevant in determining whether a particular practice is part of the 'business of insurance' " within the meaning of § 2(b) of the Act:

> *first*, whether the practice has the effect of transferring or spreading a policyholder's risk; *second*, whether the practice is an integral part of the policy relationship between the insurer and the insured; and *third*, whether the practice is limited to entities within the insurance industry.

Id. at 129. The court also noted that "[n]one of these criteria is necessarily determinative in itself." *Id.*

The parties have identified only two federal cases addressing the particular question raised in the present case, that is, whether the liquidation of an insolvent insurance company constitutes the "business of insurance" as that term is used in McCarran-Ferguson Act § 2(b). In each of these cases the court rejected the position asserted by plaintiff and held that the liquidation of an insolvent insurance company, and the priority to be given to claims made therein, does not constitute the business of insurance within the meaning of 15 U.S.C. § 1012(b). *State of Idaho ex rel. Soward v. United States*, 858 F.2d 445

(9th Cir. 1988), *cert. denied*, 109 S. Ct. 2063 (1989); *Gordon v. United States Dept. of the Treasury*, 668 F. Supp. 483 (D. Md. 1987), *affirmed*, 846 F.2d 272 (4th Cir.), *cert. denied*, 109 S. Ct. 390 (1988).[2] Plaintiff asserts that these two cases wrongly applied the Supreme Court precedents as to what constitutes the business of insurance.

The state regulation at issue in this case, Ohio Rev. Code Chapter 3903, provides a comprehensive scheme for the supervision, rehabilitation, and/or liquidation of insurance companies. The Superin-

---

[2] *See also Langdeau v. United States*, 363 S.W. 2d 327, 331 (Tex. Civ. App. 1962) (holding that the state's priority statute did not regulate the business of insurance and therefore the federal government's tax claims were entitled to first priority).

This result also finds some support in *Royal Drug* itself:

> Many aspects of insurance companies are regulated by state law, but are not the "business of insurance." Similarly, the enabling statutes in existence at the time the Act was enacted typically regulated such diverse aspects of the plans as the composition of their boards of directors, when their books and records could be inspected, how they could invest their funds, *when they could liquidate* or merge, as well as how they could purchase goods and services by entering into provider agreements.
>
> Provider agreements are no more the "business of insurance" because they were regulated by state law at the time of the McCarran-Ferguson Act than are these other facets of the plans which were similarly regulated. If Congress had exempted the "business of insurance companies," then these aspects of the plans which are not themselves insurance as that term is commonly understood would nevertheless be arguably exempt. But since Congress explicitly rejected this approach, they are not within the exemption even though they are the subject of state regulation.

Id. at 230 n.38 (emphasis added).

tendent of Insurance may file a complaint seeking an order to liquidate an insurer for one of a number of reasons, Ohio Rev. Code § 3903.17, and if the Court of Common Pleas issues an order to liquidate the superintendent is appointed as liquidator and is directed to liquidate the company. Ohio Rev. Code § 3903.18(A). Within such liquidation Ohio Rev. Code § 3903.43 establishes the priorities for payment of claims. Under section 3903.43 administrative costs are given first priority, and wage claims of employees are given second priority. Third priority includes "[a]ll claims under policies for losses incurred." The claims of the federal government are fifth in priority, behind the claims of general creditors. The issue presented is whether the liquidation regulations, and particularly the above priority scheme, constitute the "business of insurance."

There appears to be some question raised as to whether the *Royal Drug-Pireno* three-part test should be applied at all to activity which falls outside the antitrust exemption context. Plaintiff and defendant each argue in their respective motions as if that test is applicable in this case. However, plaintiff also relies upon a recent law review article in which the author argues that the *Royal Drug-Pireno* test is not applicable in the situation presented because those cases were limited to the McCarran-Ferguson Act's antitrust exemption which is not implicated in a dispute over priority of claims. Howard, *Uncle Sam Versus the Insurance Commissioners: A Multi-level Approach to Defining the "Business of Insurance" Under the McCarran-Ferguson Act*, 25 Willamette L. Rev. 1, 79 (1989). This Court is not persuaded that the *Royal Drug-Pireno* definition of "business of insurance" is limited to the use of that term in the antitrust exemption, as the Court sees no convincing

reason why the term "business of insurance" should be given different interpretations when used more than once in the same statute. Neither *Royal Drug* nor *Pireno* suggest any intention to limit the three-part test to strictly antitrust exemption cases. *Accord Gordon v. United States Dep't of the Treasury*, 846 F.2d 272, 273 (4th Cir. 1988) (finding that the Supreme Court's discussions of the definition of "business of insurance" in *Royal Drug* and *Pireno* "are not, expressly or by logical implication, limited to the antitrust context").[3] Indeed, the Supreme Court has subsequently used the test to define the insurance business in other contexts. *See Metropolitan Life Ins. Co. v. Massachusetts*, 471 U.S. 724, 742-44 (1985) (using *Pireno* test in defining the "regulation of insurance" as that term is used in the ERISA insurance savings clause, 29 U.S.C. § 1144 (b)(2)(A)); *Pilot Life Ins. Co. v. Dedeaux*, 481 U.S. 41, 50-51 (1987) (same). Thus this Court rejects a "multi-definitional approach" to the term "business of insurance" and holds that *Royal Drug* and *Pireno* set forth the appropriate test for determining the scope of that term in 15 U.S.C. § 1012 regardless of the context in which such determination is called for.[4]

---

[3] While Howard cites *Hahn v. Oregon Physicians Serv.*, 689 F.2d 840, 842 (9th Cir. 1982), *cert. denied*, 462 U.S. 1133 (1983), as "suggesting" that *Royal Drug* and *Pireno* are limited to the antitrust exemption, this Court does not read *Hahn's* discussion of *Royal Drug* and *Pireno* as a limitation on those cases.

[4] At least one other commentator has also suggested that the term "business of insurance" has different meanings within 15 U.S.C. § 1012(b). *See* Note, *The Definition of "Business of Insurance" Under the McCarran-Ferguson Act*

Pireno first directs the Court's attention to the question "whether the practice has the effect of transferring or spreading a policyholder's risk." *Pireno*, 458 U.S. at 129. The *Gordon* court, analyzing the Maryland priority statute similar to Ohio Rev. Code § 3903.43, rejected the argument that liquidation of insolvent insurance companies does effect the transferring or spreading of a policyholder's risk. *Gordon*, 668 F. Supp. at 489-91. With regard to when that risk is transferred the court relied on the clear statement in *Pireno* that, "The transfer of risk from insured to insurer is effected by means of the contract between the parties—the insurance policy—and that transfer is complete at the time that the contract is entered." *Pireno*, 458 U.S. at 130.[5] The *Gordon* court noted that "[t]he risk that an insurance company will become insolvent . . . is not the kind of risk transfer emphasized in *Pireno* and *Royal Drug*." *Gordon*, 668

After Royal Drug, 80 Colum. L. Rev. 1475, 1484 (1980). However, neither Howard nor the author of this Note cite any authority for such a proposition other than a general reference to legislative intent. In this Court's view, if Congress had intended that "business of insurance" be given multiple definitions it could have used different terms or otherwise so stated.

[5] On this point, this Court rejects plaintiff's assertion that "the risk is not spread in reality until insurer assets are used to pay a covered loss." The language used by the Supreme Court is clear and suggests no distinction between a "theoretical" spreading of risk and a "real" spreading of risk. In fact, the Supreme Court expressly rejected the very same argument in *Pireno*, stating that the premise that the transfer of risk takes place "when the insured's claim is settled" is "contrary to the fundamental principle of insurance that the insurance policy defines the scope of risk assumed by the insurer from the insured." *Id.* at 131.

F. Supp. at 490. This Court agrees that the liquidation process, with its prioritization and payment of claims, does not involve the transfer of spreading of policyholder risk as explained in *Pireno* and *Royal Drug*. The first of the three criteria identified in *Pireno* would therefore suggest that the liquidation of insolvent insurance companies does not constitute the business of insurance. As this Court does not believe that this factor alone is determinative, *Pireno*, 458 U.S. at 129, the Court will consider the remaining elements of the test as well.

The Court is unpersuaded by plaintiff's arguments on the second prong of the *Pireno* test, that is, "whether the practice is an integral party of the policy relationship between the insurer and the insured." *Pireno*, 458 U.S. at 129. On this point the *Gordon* court noted that, "The contractual liability pay on a policy of insurance is obviously distinct from the question of who gets paid first." *Gordon*, 668 F. Supp. at 491. The court further stated: "Whether the individual policyholder would be entitled to payment was determined when the contract was entered into; that is, when the risk was transferred, and at the time of payment, if any." *Id.* This Court is not persuaded by plaintiff's argument that such reasoning is "preposterous."

Finally, the Court believes that the liquidation process is not "limited to entities within the insurance industry." *Pireno*, 458 U.S. at 129. The state priority statute obviously effects the claims of various types of creditors. Moreover, as noted in *Gordon*, "Insolvency and priority statutes . . . are not peculiar to the insurance industry. The appropriate focus of the 'business of insurance' analysis is the nature of the activity itself, not the type of business that is conduct-

ing it." *Gordon*, 668 F. Supp. at 491 (citing *Perry v. Fidelity Union Life Ins. Co.*, 606 F.2d 468, 470 (5th Cir. 1979), *cert. denied*, 446 U.S. 987 (1980)).

The *Soward* court took a different approach to the conclusion that insurance company liquidation is not the business of insurance. Applying *National Securities*, 393 U.S. 453, the court recognized that the liquidation statute "deals with insurance companies that no longer are in the business of insurance." *Soward*, 858 F.2d at 452. The state priority statute therefore governs not the insurer-insured relationship but rather the relationship between debtor and creditor. *Id.* The court found it unnecessary to consider the three-part test of *Royal Drug* and *Pireno* for two reasons: (1) because of the insurance company's insolvency and liquidation "there is no activity of an insurance company to be assessed"; and (2) the state priority statute does not implicate policyholders as such either directly or indirectly. *Id.* at 453.[6] However, the court also noted that even under the *Royal Drug-Pireno* test the state priority statute does not regulate the business of insurance. *Id.* at 453-54.

There is some support, however, for plaintiff's position. In *Levy v. Lewis*, 635 F.2d 960 (2d Cir. 1980), the Second Circuit considered the application of the abstention doctrine in the context of an ERISA action filed in federal court against the liquidator of an insurance company by former employees of the company. Citing the McCarran-Ferguson Act, the court expressed its view that "the administrative and judicial scheme erected by New York to regulate insurance companies, including that part enabling the institution and implementation of liquidation proceedings, operates pursuant to an express federal policy of noninterference in insurance matters." *Id.* at 963. Accordingly, the court concluded that the federal courts should abstain in cases raising ERISA claims which such claims can be resolved in the state liquidation proceeding. *Id.* at 967. Other abstention cases have similarly held that a federal court should stay its hand when presented with a claim to the assets of an insolvent insurance company where such claim can be presented to and resolved by a state court presiding over the liquidation of that company. *See, e.g.*, *Lac D'Amiante du Quebec, Ltee. v. American Home Assurance Co.*, 864 F.2d 1033 (3d Cir. 1988); *Grimes v. Crown Life Ins. Co.*, 857 F.2d 699 (10th Cir. 1988), *cert. denied*, 109 S.Ct. 1568 (1989); *Corcoran v. Ardra Ins. Co., Ltd.*, 842 F.2d 31 (2d Cir. 1988).

[6] The *Soward* court described *Royal Drug* and *Pireno* as "refinements of the seminal analysis of *National Securities* tailored to address activities of insurance companies that would implicate the antitrust laws in the absence of the McCarran-Ferguson Act." *Id.* at 453.

Although the principles underlying the abstention doctrine are clearly inapposite in the present case, the Court does read the above abstention cases as based at least in part on a theory that state regulation of insurance company insolvency and rehabilitation constitutes regulation of the business of insurance within the meaning of the McCarran-Ferguson Act. In the Court's view, as noted earlier, the question of whether liquidation of insolvent insurance companies constitutes the business of insurance should not depend on the context in which that question is asked. *Cf. Lac D'Amiante du Quebec*, 864 F.2d at 1039 n.8 (finding that reliance upon the McCarran-Ferguson Act in the abstention context "does not require us to discern whether state regulation of insurer insolvencies con-

stitutes regulation of the business of insurance for other purposes"). Nevertheless, the Court is persuaded that *Soward* and *Gordon* reached the correct result of the central issue presented. The abstention cases cited above did not specifically analyze the scope of the term "business of insurance" under the criteria set forth in *Royal Drug* and *Pireon*. *See Gordon*, 668 F. Supp. at 489 n.8; *but see United Services Auto. Ass'n v. Muir*, 792 F.2d 356, 365 (3d Cir. 1986) (citing the *Pireno* test and noting that the state regulations at issue in *Levy* "concerned both the future coverage of policyholders and their relationship with a defunct insurer, and so were authorized under McCarran-Ferguson"), *cert. denied*, 479 U.S. 1031 (1987). The Supreme Court has established the test for determining what constitutes the "business of insurance," and the only cases applying that test to insurance company liquidation have concluded that such activity does *not* constitute the business of insurance.

In summary, in the absence of controlling authority to the contrary, the Court is persuaded by the analysis set forth in *Gordon*, and concurs in the result reached in both *Gordon* and *Soward*. From plaintiff's perspective there may indeed be strong policy arguments behind allowing states complete control in prioritizing claims to the assets of an insolvent insurer under liquidation. However, such control would work at the expense of the policy underlying the federal priority statute, which is the securing of an adequate revenue to sustain the public burdens and discharge the public debts. *See United States v. Moore*, 423 U.S. 77, 80-83 (1975). In any event, as explained above, the United States Supreme Court appears to have adopted a somewhat limited defintion

of the "business of insurance" as that term is used in section 2(b) of the McCarran-Ferguson Act. Under the Supreme Court's analysis the scope of the term "business of insurance" is limited to those activities directly or indirectly affecting the risk transfer indicative of the insured-insurer relationship. As correctly determined in both *Gordon* and *Soward*, the liquidation of insolvent insurance companies and the concomitant prioritization of claims do not affect the transfer or spreading of risk. Accordingly, this Court concludes that Ohio Rev. Code § 3903.42 is not a state law regulating the "business of insurance" within the meaning of 15 U.S.C. § 1012(b).

The Court therefore concludes that the federal priority statute, 31 U.S.C. § 3713(a), is not limited in its application in this case by 15 U.S.C. § 1012(b). Under 31 U.S.C. § 3713(a) the claims of the United States are entitled to first priority in the liquidation of ADIC. To the extent Ohio Rev. Code § 3903.42 provides a lesser priority it is inconsistent with federal law. Pursuant to Article VI clause 2 of the United States Constitution, 31 U.S.C. § 3713 controls notwithstanding the contrary Ohio Rev. Code § 3903.42. Having reached this conclusion, the court need not address the arguments of the parties as to the priority given to the claims of the federal government under Ohio Rev. Code § 3903.42, or plaintiff's argument as to why that issue should not be addressed by this Court.

B. *Priority of Claims Under the Miller Act.*

The second issue raised by the parties concerns whether certain claims asserted by defendants in the ADIC liquidation are "claim[s] of the United States Government" within the meaning of 31 U.S.C. § 3713(a). Plaintiff herein argues that certain of the

claims asserted by defendants are claims on Miller Act payment bond which are not claims of the United States. Defendants respond that the purposes of the Miller Act would be defeated if the claims asserted pursuant to that Act are not given the protection afforded in the federal priority statute. Although some of the claims at issue in *Gordon* were claims of materialmen, suppliers and subcontractors under Miller Act payment bonds, the parties therein had resolved their dispute as to those claims and thus the court did not specifically address whether such claims were debts owed to the United States under 31 U.S.C. § 3713(a). *Gordon*, 668 F. Supp. at 485 n.1.

To resolve this issue, as plaintiff correctly notes, this Court need look no further than the plain language of the Miller Act. The Act, 40 U.S.C. § 270b, provides in pertinent part:

> (a) Every person who has furnished labor or material in the prosecution of the work provided for in such contract, in respect of which a payment bond is furnished under sections 270a to 270d of this title and who has not been paid in full therefor before the expiration of a period of ninety days after the day on which the last of the labor was done or performed by him or material was furnished or supplied by him for which such claim is made, shall have the right to sue on such payment bond for the amount, or the balance thereby unpaid at the time institution of such suit and to prosecute said action to final execution and judgment for the sum or sums justly due him. . . .
>
> (b) Every suit instituted under this section shall be brought in the name of the United States for the use of the person suing, ... The United States shall not be liable for the payment of any costs or expenses of any such suit.

From the language of 40 U.S.C. § 270b it is clear that it provides to certain laborers and materialmen a cause of action on payment bonds required by the Miller Act. While the suit is brought "in the name of the United States for the use of the person suing," it is clear that the cause of action belongs to the laborer, materialman, or subcontractor and not to the nominal party the United States. *See Blanchard v. Terry & Wright, Inc.*, 331 F.2d 467, 469-70 (6th Cir.) (holding that the interest of the United States in such an action is "merely nominal" and that the "use plaintiffs," the laborers, materialmen, or subcontractors, are "the real parties in interest"), *cert. denied*, 379 U.S. 831 (1964). In this regard, of course, a "payment" bond must be distinguished from a "performance" bond. Pursuant to 40 U.S.C. § 270a(a), a performance bond is required "for the protection of the United States," while a payment bond is to provide "protection of all persons supplying labor and material." *See United States for the Use and Benefit of Bryant Electric Co. v. Aetna Casualty & Surety Co.*, 297 F.2d 665, 668 (2d Cir. 1962) ("The government, being safeguarded by the performance bond, had no direct interest in the payment bond."). Notwithstanding the single reference on page 31 of defendants' memorandum to "performance bonds," the Court understands that the disputed issue is the priority to be afforded Miller Act payment bond claimants.

Defendant argues that "the federal priority must apply to Miller Act payment bond claimants in order

to afford the Miller Act its proper role in the federal body of law." It is recognized that the purpose behind the Miller Act is to afford protection to person supplying labor and materials on federal construction projects. *See United States for the Benefit of Sherman v. Carter*, 353 U.S. 210, 216 (1957). However, defendants have stated no convincing reason why that policy requires treating Miller Act claims of laborers and materialmen as claims of the United States for purposes of the federal priority statute. It may well advance the policies behind the Miller Act to elevate the priority of payment bond claimants. However, as plaintiff correctly states, that is a matter for Congress and not for this Court. Therefore, this Court concludes that claims of laborers, materialmen, and subcontractors under Miller Act payment bonds are not debts owed to the United States government under the federal priority statute. *Accord, Florida Bank & Trust Co. v. Union Indemnity Co.*, 55 F.2d 640, 641 (4th Cir.), *cert. denied*, 287 U.S. 600 (1932).

CONCLUSION

The Court concludes that the liquidation of an insolvent insurance company, and its attendant prioritization of claims, does not constitute the "business of insurance" within the meaning of 15 U.S.C. § 1012(b) as that term has been defined by the United States Supreme Court. Thus, the federal priority statute, 31 U.S.C. § 3713, does not "invalidate, impair, or supersede" a state law regulating the business of insurance notwithstanding that it affords a higher priority to claims of the federal government than that provided in Ohio Rev. Code § 3903.42. Accordingly, the claims of the United

States in the ADIC liquidation are entitled to first priority. However, such claims do not include the claims of laborers, materialmen, and subcontractors suing on payment bonds under the Miller Act. Such claims belong to the laborers, materialmen, or subcontractors themselves and are not claims of the federal government within the meaning of 31 U.S.C. § 3713. Accordingly, the Miller Act payment bond claims are entitled to whatever priority is afforded them under Ohio Rev. Code § 3903.42.

For the foregoing reasons, the summary judgment motions of plaintiff and defendant are hereby each GRANTED IN PART AND DENIED IN PART. The Court hereby enters judgment as follows: (1) The claims of the United States are entitled to first priority in the ADIC liquidation, pursuant to 31 U.S.C. § 3713, notwithstanding the contrary provision of Ohio Rev. Code § 3903.42; and (2) the claims of laborers, materialmen, and subcontractors under Miller Act payment bonds are not claims of the United States and thus are entitled only to the priority afforded them under Ohio Rev. Code § 3903.42.

IT IS SO ORDERED.

/s/ John D. Holschuh
JOHN D. HOLSCHUH, Judge
United States District Court

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 90-3364

GEORGE FABE, Superintendent of Insurance,
State of Ohio, PLAINTIFF-APPELLANT

v.

UNITED STATES DEPARTMENT OF THE TREASURY;
MITCHELL A. LEVINE, Assistant Commissioner,
DEFENDANTS-APPELLEES

Before: Martin and Jones, Circuit Judges;
Edgar, District Judge

JUDGMENT

[Filed Jul. 17, 1991]

ON APPEAL from the United States District Court for the Southern District of Ohio at Columbus.

THIS CAUSE was heard on the record from the district court and was argued by counsel.

ON CONSIDERATION WHEREOF, it is ordered that the judgment of the district court is reversed and the case is remanded for entry of judgment in

favor of the liquidation of American Druggists' Insurance Company pursuant to Ohio law.

ENTERED BY ORDER OF THE COURT

/s/ Leonard Green
LEONARD GREEN
Clerk

A True Copy.
Attest:

/s/ [Illegible]
Deputy Clerk

Issued as Mandate: December 2, 1991

COSTS: None

Filing Fee	$
Printing	$
Total	$

APPENDIX D

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 90-3364

GEORGE FABE, SUPERINTENDENT OF INSURANCE,
STATE OF OHIO, PLAINTIFF-APPELLANT

v.

UNITED STATES DEPARTMENT OF THE TREASURY;
MITCHELL A. LEVINE, ASSISTANT COMMISSIONER,
DEFENDANTS-APPELLEES

BEFORE: MARTIN and JONES, Circuit Judge; and EDGAR,* United States District Judge.

ORDER

[Filed Nov. 21, 1991]

The court having received a petition for rehearing en banc, and the petition having been circulated not only to the original panel members but also to all other active judges of this court, and no judge of this court having requested a vote on the suggestion

* Hon. R. Allan Edgar sitting by designation from the Eastern District of Tennessee.

for rehearing en banc, the petition for rehearing has been referred to the original hearing panel.

The panel has further reviewed the petition for rehearing and concludes that the issues raised in the petition were fully considered upon the original submission and decision of the case. Accordingly, the petition is denied.

ENTERED BY ORDER OF THE COURT

/s/ Leonard Green
LEONARD GREEN
Clerk

☆ U. S. GOVERNMENT PRINTING OFFICE; 1992 312324 45339

(2)

Supreme Court, U.S.
FILED
APR 13 1992
OFFICE OF THE CLERK

No. 91-1513

IN THE

Supreme Court of the United States

October Term, 1991

UNITED STATES DEPARTMENT OF THE TREASURY AND MITCHELL A. LEVINE, ASSISTANT COMMISSIONER,
Petitioners,

vs.

GEORGE FABE, SUPERINTENDENT OF INSURANCE, STATE OF OHIO,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

RESPONDENT'S BRIEF IN OPPOSITION

JAMES R. RISHEL
Counsel of Record
ZACHARY T. DONOVAN
RISHEL, MYERS & KOPECH
280 North High Street
Suite 800
Columbus, Ohio 43215
(614) 221-0717
Counsel for Respondent

Of Counsel:
LEE I. FISHER
Attorney General of Ohio

THE GATES LEGAL PUBLISHING CO., CLEVELAND, OHIO—TEL. (216) 621-5647

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases:

Statutes:

No. 91-1513

IN THE

Supreme Court of the United States

October Term, 1991

UNITED STATES DEPARTMENT OF THE TREASURY AND MITCHELL A. LEVINE, ASSISTANT COMMISSIONER,
Petitioners,

vs.

GEORGE FABE, SUPERINTENDENT OF INSURANCE, STATE OF OHIO,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

RESPONDENT'S BRIEF IN OPPOSITION

STATUTORY PROVISIONS INVOLVED

In addition to the statutes cited by the Petitioners, the following provisions of Ohio's Insurers Supervision, Rehabilitation and Liquidation Act, Chapter 3903, Revised Code, are important to a consideration of the question presented by the Petitioners.

Section 3903.02(D), Revised Code:

(D) The purpose of sections 3903.01 to 3903.59 of the Revised Code is the protection of the interests of insureds, claimants, creditors, and the public generally, with minimum interference with the normal prerogatives of the owners and managers of insurers, through all of the following:

(1) Early detection of any potentially dangerous condition in an insurer, and prompt application of appropriate corrective measures;

(2) Improved methods for rehabilitating insurers, involving the cooperation and management expertise of the insurance industry;

(3) Enhanced efficiency and economy of liquidation, through clarification of the law, to minimize legal uncertainty and litigation;

(4) Equitable apportionment of any unavoidable loss;

(5) Lessening the problems of interstate rehabilitation and liquidation by facilitating cooperation between states in the liquidation process, and by extending the scope of personal jurisdiction over debtors of the insurer outside this state;

(6) Regulation of the insurance business by the impact of the law relating to delinquency procedures and substantive rules on the entire insurance business.

Section 3903.42, Revised Code:

The priority of distribution of claims from the insurer's estate shall be in accordance with the order in which each class of claims is set forth in this section. Every claim in each class shall be paid in full or adequate funds retained for such payment before the members of the next class receive any

payment. No subclasses shall be established within any class. The order of distribution of claims shall be:

(a) Class 1. The costs and expenses of administration, including but not limited to the following:

(1) The actual and necessary costs of preserving or recovering the assets of the insurer;

(2) Compensation for all services rendered in the liquidation;

(3) Any necessary filing fees;

(4) The fees and mileage payable to witnesses;

(5) Reasonable attorney's fees;

(6) The reasonable expenses of a guaranty association, or foreign guaranty association in handling claims.

(B) Class 2. Debts due to employees for services performed to the extent that they do not exceed one thousand dollars and represent payment for services performed within one year before the filing of the complaint for liquidation. Officers and directors shall not be entitled to the benefit of this priority. Such priority shall be in lieu of any other similar priority that may be authorized by law as to wages or compensation of employees.

(C) Class 3. All claims under policies for losses incurred, including third party claims, all claims against the insurer for liability for bodily injury or for injury to order destruction of tangible property that are not under policies, and all claims of a guaranty association or foreign guaranty association. All claims under life insurance and annuity policies, whether for death proceeds, annuity proceeds, or investment values, shall be treated as loss claims. That portion of any loss, indemnification for which is provided by other

benefits or advantages recovered by the claimant, shall not be included in this class, other than benefits or advantages recovered or recoverable in discharge of familial obligations of support or by way of succession at death or as proceeds of life insurance, or as gratuities. No payment by an employer to an employee shall be treated as a gratuity. Claims under nonassessable policies for unearned premium or other premium refunds.

(D) Class 4. Claims of general creditors.

(E) Class 5. Claims of the federal or any state or local government. Claims, including those of any governmental body for a penalty or forfeiture, shall be allowed in this class only to the extent of the pecuniary loss sustained from the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby. The remainder of such claims shall be postponed to the class of claims under division (H) of this section.

(F) Class 6. Claims filed late or any other claims other than claims under divisions (G) and (H) of this section.

(G) Class 7. Surplus or contribution notes, or similar obligations, and premium refunds on assessable policies. Payments to members of domestic mutual insurance companies shall be limited in according with law.

(H) Class 8. The claims of shareholders or other owners.

ARGUMENTS FOR DENYING THE PETITION

Respondent agrees that the decision of the court of appeals squarely conflicts with decisions of the two other courts of appeals that have decided the issue. *See Idaho ex rel. Soward v. United States*, 858 F.2d 445 (9th Cir. 1988), *cert. denied*, 490 U.S. 1065 (1989); *Gordon v. United States Dep't of the Treasury*, 846 F.2d 272 (4th Cir.), *cert. denied*, 488 U.S. 954 (1988). Respondent also agrees that the question presented is an important one, although not for the reason articulated by the Petitioners. The important question is not the effect upon federal revenue.[1] Rather, the question is the preservation of the congressional purpose underlying the McCarran-Ferguson Act, 15 U.S.C. 1012, to "broadly give support to the existing and future state systems for regulating and taxing the business of insurance." *Prudential Insurance Company v. Benjamin*, 328 U.S. 408, 429 (1946).

1. The court of appeals correctly concluded that Section 3903.42, Revised Code, is exempt from federal preemption as a regulation of the "business of insurance" within the McCarran-Ferguson Act. The court of appeals' conclusion does not conflict with precedents of this Court.

Petitioners' argument on this point is simply that the liquidation of an insolvent insurance company pursuant to the provisions of state insurance insolvency statutes does not neatly fall within the three criteria set out in *Union Labor Life Insurance Co. v. Pireno*, 458 U.S. 119 (1982):

[1] The claims of the federal government filed with the Liquidator of the American Druggists' Insurance Company arise from bonds issued by ADIC as surety not from tax claims owed by ADIC to the United States Treasury.

> First, whether the practice has the effect of transferring or spreading a policyholder's risk; second, whether the practice is an integral part of the policy relationship between the insurer and the insured; and third, whether the practice is limited to entities within the insurance industry.

458 U.S. at 129.

However, the Petitioner's argument that the court of appeals misapplied and misconstrued all three prongs of the *Pireno* test simply ignores the appellate court's analysis.

a. With regard to the first prong of the *Pireno* test, the Petitioners argue that the "Ohio priority statute does not have the effect of tranferring and spreading a policyholder's risk." Petition at 8. Petitioners' erroneous conclusion results from their tortured interpretation that only events surrounding the actual issuance of the insurance policy could satisfy *Pireno* and that the transfer of risk is complete at the time the insurance policy is issued. Such a narrow interpretation evidences a benighted appreciation for the realities of the true business of insurance. Moreover, Petitioners' contentions are a poor analysis of the first prong of the test and flatly ignore the specific language of *S.E.C. v. National Securities, Inc.*, 393 U.S. 453 (1969). In *National Securities,* Justice Marshall enumerated several examples of activities which constitute the "business of insurance" including fixing of rates, selling and advertising of policies and the licensing of companies and their agents. 393 U.S. at 460. The Court further stated:

> The relationship between insurer and insured, the type of policy which could be issued, *its reliability, interpretation, and enforcement—these were the core of the "business of insurance."* Undoubtedly, other activities of insurance companies relate so closely to their status as reliable insurers that they too must be placed in the same class. But whatever the exact scope of the statutory term, it is clear where the focus was—it was on the relationship between the insurance company and the policyholder. *Statutes aimed at protecting* or regulating *this relationship, directly or indirectly, are laws regulating the "business of insurance."* (emphasis added).

393 U.S. at 460.

Indeed, the Court in *National Securities* evidenced a broad interpretation to the term "business of insurance":

> The applicable statute requires the state director of insurance to find that the proposed merger would not "substantially reduce the security of and service to be rendered to policyholders" before he gives his approval (citation omitted). This section of the statute clearly relates to the "business of insurance."

393 U.S. at 462.

Accordingly, contrary to the assertions of Petitioners, *National Securities* broadly interpreted the language and intent of McCarran-Ferguson to apply to statutes aimed, directly or indirectly, at securing the interests of those purchasing insurance policies, and assuring the reliability of those policies.

To appreciate the fatal error of the Petitioners' analysts, one need only apply their interpretation to the examples set forth by Justice Marshall in *National Securities.* The fixing of rates, the adjusting of policies and the licensing of insurance companies and their agents could not satisfy the Petitioners' narrow interpretation of the first prong of the *Pireno* test. Yet, state statutes regulating these activities would clearly constitute the regulation of the "business of insurance" within McCarran-Ferguson.

The purely sterile environment of Petitioners' theoretical argument about risk spreading seems to only account for the precise instant in time when the insured and insurer enter the contract. However, risk spreading without insuring the reliability of the insurer who has insured the risk is of no value to the insured and does not carry out the specific intent of the insurance contract. Section 3903.42, Revised Code supports the entire contractual risk transfer process between insurer and insured by providing some assurance that the transfer of the risk to the insurer will be accomplished in the event of the insurer's insolvency. The court of appeals correctly concluded that the first prong of the *Pireno* test was satisfied.

b. Section 3903.42, Revised Code, effects the essence of the central contractual relationship between the insurer and the insured by reinforcing the relationship and underscoring the enforcement of that contractual relationship when the insurer is financially impaired. Section 3903.42, Revised Code is designed to strengthen the contractual relationship by prioritizing the claims of policyholders and thereby enhancing the reliability of the contractual relationship. The liquidation statutes, and specifically Section 3903.42, Revised Code, go directly to the heart of reliability and enforceability of the insurance policies as they provide mechanisms for adjustment of claims, the defense of insureds, the interpretation of policies and the payment of proper claims. To reach another conclusion would not comport with the realities of the "business of insurance."

Petitioners argue that Section 3903.42, Revised Code, is not integral to the contractual relationship between the insurance company and the insured as it is "obviously distinct from the contract of insurance itself." (Petition at 10). Any state statute regulating the business of insurance is distinct from the contract of insurance. Section 3903.42, Revised Code, is integral to the relationship between the insolvent insurer and its policyholders as it protects the claims of policyholders arising from their contractual relationship with the insolvent insurer. In fact, the insurer/insured relationship is in sharper focus in liquidation proceedings than in everyday insurance business. There are no stockholders to satisfy, no bottom line profit to be reached. The single goal of insurance liquidation is to maximize the potential recovery of those who have relied on the insurer over the years—the policyholders. The Petitioners' attempt to argue to the contrary simply ignores the true facts of the liquidation process. Section 3903.42, Revised Code, also satisfies the second prong of the *Pireno* test.

c. The Petitioners argue that the third prong of the *Pireno* test is not satisfied, as that the liquidation process is not limited to entities within the insurance industry. The flaw in this argument is the simple fact that the liquidation statutes can only be applied to insolvent insurance companies. Chapter 3903, Revised Code, is, by definition, limited in application to *only* those entities within the insurance industry. Section 3903.03, Revised Code. The fact that "other" claimants are listed in the priority statute simply takes into account the realities of the business and the fact that other claims may exist. The focus, however, is on the insurer/insured, entities clearly within the insurance industry. When the liquidation statute is viewed in total, the third prong of the *Pireno* test is also clearly satisfied.

2. The decision of the court of appeals is not inconsistent with the purpose and legislative history of the McCarran-Ferguson Act. Indeed the appellate court correctly acknowledged the purpose of the Act: "Congress passed the McCarran-Ferguson Act, 15 U.S.C.

§1012, to protect the domain of the state over the 'existing and future ... systems for regulating and taxing the business of insurance.' *Prudential Insurance Co. v. Benjamin*, 328 U.S. 408, 429 (1946)." (Decision, 4a of Appendix to Petition). The court of appeals also correctly dispensed with Petitioners' argument that *United States v. Knott*, 298 U.S. 544 (1936) is dispositive of this matter:

> First, McCarran-Ferguson did not return to the status quo prior to South-Eastern Underwriters; instead, it only permitted state regulation of the "business of insurance," without federal interference. Royal Drug, 440 U.S. at 220 n. 24. Second, even if it had, the Florida statute at issue in Knott contained only generalized provisions protecting domestic creditors in Florida insurance companies over foreign creditors; it in no way regulated the "business of insurance" for the protection of the insured.

Decision, 13a-14a, Appendix to Petition.

Moreover, Petitioners ignore the plain language of 15 U.S.C. 1012(B) that:

> "*No* Act of Congress shall be construed to invalidate, impair, or supercede any law enacted by any state for the purpose of regulating the business of insurance ... unless such Act specifically relates to the business of insurance. (Emphasis added).

Thus, *all* federal statutes that do not relate specifically to insurance are subordinated to state law, except those (*e.g.*, the Sherman Act, etc.) specifically mentioned in the remaining portion of paragraph (B) not quoted above. By failing to expressly preserve the supremacy of the federal claims priority statute, that supremacy was lost. The court of appeals' analysis of the purpose and legislative history of the McCarran-Ferguson Act was correct and its decision was totally consistent with both the purpose and legislative history of the Act.

CONCLUSION

While the decision of the court of appeals conflicts with decisions of the two other circuits which have ruled on the important question presented in this case, the decision is correct and the petition for a writ of certiorari should be denied.

Respectfully submitted,

JAMES. R. RISHEL
Counsel of Record
ZACHARY T. DONOVAN
RISHEL, MYERS & KOPECH
280 North High Street
Suite 800
Columbus, Ohio 43215
(614) 221-0717
Counsel for Respondent

Of Counsel:
LEE I. FISHER
Attorney General of Ohio

(3)

No. 91-1513

In the Supreme Court of the United States

OCTOBER TERM, 1992

UNITED STATES DEPARTMENT OF THE TREASURY AND
MITCHELL A. LEVINE,
ASSISTANT COMMISSIONER, PETITIONERS

v.

GEORGE FABE, SUPERINTENDENT OF INSURANCE,
STATE OF OHIO

---

*ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT*

BRIEF FOR THE PETITIONERS

KENNETH W. STARR
Solicitor General

STUART M. GERSON
Assistant Attorney General

MAUREEN E. MAHONEY
Deputy Solicitor General

ROBERT A. LONG, JR.
Assistant to the Solicitor General

WILLIAM KANTER
JENNIFER H. ZACKS
Attorneys

*Department of Justice
Washington, D.C. 20530
(202) 514-2217*

40

QUESTION PRESENTED

The federal priority statute, 31 U.S.C. 3713(a), requires that a debtor's obligations to the United States be given first priority in state insolvency proceedings. An Ohio statute provides that claims of the United States are entitled to fifth priority in proceedings to liquidate an insolvent insurance company. The federal priority statute preempts the state priority statute unless the state statute is subject to the anti-preemption provisions of the McCarran-Ferguson Act, 15 U.S.C. 1012. Accordingly, the question presented is:

Whether a state statute establishing the priority of creditors' claims in a proceeding to liquidate an insolvent insurance company is a law regulating "the business of insurance" within the meaning of the McCarran-Ferguson Act.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

In the Supreme Court of the United States

OCTOBER TERM, 1992

No. 91-1513

UNITED STATES DEPARTMENT OF THE TREASURY AND
MITCHELL A. LEVINE,
ASSISTANT COMMISSIONER, PETITIONERS

v.

GEORGE FABE, SUPERINTENDENT OF INSURANCE;
STATE OF OHIO

*ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT*

BRIEF FOR THE PETITIONERS

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-30a) is reported at 939 F.2d 341. The opinion of the district court (Pet. App. 31a-49a) is unreported.

JURISDICTION

The judgment of the court of appeals (Pet. App. 50a-51a) was entered on July 17, 1991. A petition for rehearing was denied on November 21, 1991. Pet. App. 52a-53a. On February 10, 1992, Justice Stevens extended the time for filing a petition for a writ of certiorari to and including March 20, 1992. The petition was filed on March 17, 1992, and was granted on May 18, 1992. The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Article VI, Clause 2 of the United States Constitution; 31 U.S.C. 3713; 15 U.S.C. 1012; and Ohio Rev. Code Ann. §§ 3903.02(D) and 3903.42 (Anderson 1989) are reproduced as an appendix to this brief. See App., *infra,* 1a-5a.

STATEMENT

1. On April 30, 1986, the Court of Common Pleas for Franklin County, Ohio, declared American Druggists' Insurance Company (ADIC) insolvent. The court ordered that ADIC be liquidated and appointed respondent, Ohio's Superintendent of Insurance, as liquidator. Pet. App. 2a.

The United States filed claims in the state liquidation proceedings in excess of $10.7 million on immigration, appearance, performance, and payment bonds issued by ADIC as surety. The United States asserted that its claims are entitled to first priority under the federal priority statute, 31 U.S.C. 3713(a)(1)(A). Pet. App. 2a. See App., *infra,* 1a.

Respondent brought a declaratory judgment action in federal district court seeking to establish that the federal priority statute does not preempt an Ohio statute that establishes the priority of claims in insurance liquidation proceedings. Under the Ohio statute, claims of federal, state, and local governments are entitled to fifth priority, ranking behind (1) administrative expenses, (2) wage and benefit claims, (3) policyholders' claims, and (4) claims of general creditors. Ohio Rev. Code Ann. § 3903.42 (Anderson 1989); see App., *infra,* 2a-4a. Respondent argued that the Ohio priority statute, rather than the federal priority statute, determines the priority of claims of the United States because of the anti-preemption provisions of the McCarran-Ferguson Act, 15 U.S.C. 1012. Pet. App. 2a-3a; see App., *infra,* 1a-2a.

2. The district court entered summary judgment for the United States. Pet. App. 31a-49a. The court first concluded that the federal priority statute governs the priority of claims of the United States against an insolvent insurer unless the Ohio priority statute is a law regulating "the business of insurance" within the meaning of the McCarran-Ferguson Act, 15 U.S.C. 1012. The court then applied this Court's three-part test for determining whether a practice is part of the business of insurance. That test looks to:

> [F]*irst,* whether the practice has the effect of transferring or spreading a policyholder's risk; *second,* whether the practice is an integral part of the policy relationship between the insurer and the insured; and *third,* whether the practice is limited to entities within the insurance industry.

Pet. App. 36a (quoting *Union Labor Life Ins. Co.* v. *Pireno,* 458 U.S. 119, 129 (1982)). As to the first factor, the court concluded that "the liquidation process, with its prioritization and payment of claims, does not involve the transfer [or] spreading of policyholder risk." Pet. App. 41a. As to the second factor, the court concluded that "[t]he contractual liability [to] pay on a policy of insurance is obviously distinct from the question of who gets paid first." *Ibid.* (quoting *Gordon* v. *United States Dep't of the Treasury,* 668 F. Supp. 483, 491 (D. Md. 1987), aff'd, 846 F.2d 272 (4th Cir.), cert. denied, 488 U.S. 954 (1988)). As to the third factor, the court observed that the Ohio priority statute "[a]ffects the claims of various types of creditors," and therefore is not limited to entities within the insurance industry. Pet. App. 41a. The court also noted that "[i]nsolvency and priority statutes * * * are not peculiar to the insurance industry." *Ibid.* (quoting *Gordon,* 668 F. Supp. at 491)). Accordingly, the district court held that a state statute determining the priority of claims against an insolvent

insurance company does not regulate the "business of insurance" within the meaning of the McCarran-Ferguson Act, and therefore the claims of the United States against ADIC are entitled to first priority under the federal priority statute.[1]

3. The court of appeals reversed. Pet. App. 1a-30a. The court of appeals, like the district court, applied *Pireno*'s three-part test for determining whether a practice is part of the business of insurance. *Id.* at 9a-11a. The court of appeals also recognized that two other courts of appeals have "rejected the argument that * * * liquidation priority statutes * * * regulate[ ] the 'business of insurance.' " *Id.* at 15a (citing *Idaho ex rel. Soward* v. *United States*, 858 F.2d 445 (9th Cir. 1988), cert. denied, 490 U.S. 1065 (1989); *Gordon* v. *United States Dep't of the Treasury*, 846 F.2d 272 (4th Cir.) (per curiam), cert. denied, 488 U.S. 954 (1988)). The court nevertheless held that the Ohio priority statute regulates the business of insurance because it "is a state regulation which protects the interests of the insured." Pet. App. 20a.

The court then held that the Ohio statute meets all three parts of *Pireno*'s tripartite test. First, the court concluded that the Ohio priority statute has the effect of transferring and spreading the policyholder's risk that the insurer will become insolvent. Pet. App. 21a-22a. Second, the court concluded that the priority statute is an integral part of the insurer-insured relationship because the statute is designed to protect that relationship by providing assurances as to the reliability of insurance policies. *Id.* at 22a. Finally, although

[1] The district court also held that claims of laborers, materialmen, and subcontractors suing on payment bonds under the Miller Act, 40 U.S.C. 270b, are not claims of the United States for purposes of the federal insolvency statute. See Pet. App. 45a-48a. The government did not appeal from that ruling.

recognizing that not all creditors of an insolvent insurance company are policyholders, the court nevertheless concluded that the third prong of *Pireno* was satisfied because the "focus" of the statute is the protection of policyholders. *Id.* at 23a.

Judge Edgar concurred separately. Pet. App. 23a-25a. He observed that, in enacting McCarran-Ferguson, Congress intended "to restore the law to its status prior to [*United States* v.] *South-Eastern Underwriters [Ass'n*, 322 U.S. 533 (1944)]." Pet. App. 24a. Judge Edgar concluded that McCarran-Ferguson did not modify the "long standing, traditional state regulation of insurance company liquidations," and therefore did not modify the type of regulation at issue in this case. *Ibid.*

Judge Jones dissented. Pet. App. 25a-30a. As to the first *Pireno* factor, he concluded that the risk of insurer insolvency is "qualitatively distinct from the risk the policyholder seeks to transfer in an insurance contract." *Id.* at 27a (quoting *Gordon*, 846 F.2d at 273). Judge Jones therefore rejected the majority's conclusion that the priority statute involves risk transfer and risk spreading. Judge Jones reasoned that the majority's view was contradicted by this Court's conclusion in *Pireno* that "[t]he transfer of risk from insured to insurer is effected by means of the contract between the parties – the insurance policy – and that transfer is complete at the time that the contract is entered." Pet. App. 27a (quoting 458 U.S. at 130). As to the second *Pireno* factor, Judge Jones concluded that the priority statute is not an integral part of the policy relationship. "Rather than playing an integral role in the policy relationship between insurer and insured," the Ohio priority statute instead "addresses 'the relationship between those left in the lurch by the expiration of the insurer.' " Pet. App. 29a (quoting *Soward*, 858 F.2d at 454). Finally, Judge Jones found that the third *Pireno* factor also supported preemption because

the Ohio priority statute is not limited to entities within the insurance industry, but instead governs the rights of all creditors. *Id.* at 30a.

SUMMARY OF ARGUMENT

1. The federal priority statute requires that claims of the United States against insolvent debtors be accorded first priority in state insolvency proceedings. Congress enacted a federal priority statute in the earliest days of the Republic; the statute has remained in effect with little substantive change for two centuries. Statutory priority for federal claims serves the vital purpose of securing an adequate federal revenue.

By its terms, the federal priority statute applies to the claims at issue in this case. Those claims are "claim[s] of the United States Government." See 31 U.S.C. 3713. In addition, ADIC has been declared insolvent, and the appointment of respondent to serve as liquidator of ADIC was a classic "act of bankruptcy" within the meaning of the statute. The Ohio priority statute directly conflicts with the federal priority statute because it ranks claims of the United States behind numerous other claims, including claims of general business creditors. Under ordinary principles of preemption, the federal priority statute applies to the claims of the United States and preempts inconsistent state law.

2. a. The McCarran-Ferguson Act does not require a different result. That Act provides that "[n]o Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance." 15 U.S.C. 1012(b). The Court has consistently distinguished between laws "regulating the business of insurance" and those regulating a variety of other corporate activities conducted by insurers.

The plain language of the McCarran-Ferguson Act answers the question presented in this case. The Ohio priority statute was not "enacted * * * for the purpose of regulating the business of insurance." 15 U.S.C. 1012(b). The purpose of the statute is to regulate the priority of competing claims of creditors in an insolvency proceeding, and to displace the historic superiority of federal claims. The law does not regulate the terms of insurance policies, or any other aspect of the commercial activities of insurers. Indeed, the statute is not even addressed to insurers. Instead, it is addressed to the liquidator or trustee of the "estate" of a defunct insurance company, and applies only when the business of the defunct company has been wound up and its assets are being distributed to its creditors.

b. Although the plain language is dispositive here, this textualist interpretation is confirmed by application of the *Pireno* test. Under that test, the Court considers (1) whether the practice at issue has the effect of transferring and spreading a policyholder's risk; (2) whether the practice is an integral part of the policy relationship between the insurer and the insured; and (3) whether the practice is limited to entities within the insurance industry. See *Union Labor Life Ins. Co.* v. *Pireno*, 458 U.S. 119, 129 (1982). Each of these factors confirms what the plain language suggests: the Ohio priority statute does not regulate the business of insurance.

An essential characteristic of the business of insurance is the spreading and underwriting of risk. The transfer of risk from the insured to the insurer is effected by means of the contract of insurance. It is complete at the time the parties enter into the contract. *Pireno*, 458 U.S. at 130. The Ohio statute does not result in any underwriting or investment risk-taking by the insurance company. The risk that the insurance company will become insolvent is not a risk covered by the insurance contract or transferred at the

time the parties enter into the contract. Instead, that risk remains with the policyholders and other creditors of the insurance company. The state insolvency statute merely determines the order in which creditors' claims will be paid.

Nor is the state priority statute integral to the relationship between the insurance company and the insured. The statute is distinct from the contract of insurance. And the statute comes into play only if the insurance company becomes insolvent and is liquidated. In that event, the insurance company ceases to exist and the relationship between the insurance company and the insured is terminated. Rather than addressing the relationship between the insurance company and the insured, the statute addresses the relationship between policyholders and other creditors of the defunct insurer.

In addition, the state priority statute plainly is not limited to entities in the insurance industry. Instead, it applies to all creditors of insolvent insurance companies, including employees and general business creditors. A priority statute does not regulate the business of insurance, but instead is a standard feature of bankruptcy laws.

3. In prior cases, this Court has defined the "business of insurance" through examination of McCarran-Ferguson's enactment history. To the extent the Court repairs to the measure's legislative background, that history strongly reinforces the conclusion that a statute regulating the priority of federal claims against an insolvent enterprise that formerly sold insurance is not a law regulating the "business of insurance." Congress passed the McCarran-Ferguson Act in response to this Court's decision in *United States* v. *South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944), which held that insurance transactions are subject to federal regulation under the Commerce Clause. The Act was intended to "turn back the clock" to pre-*South-Eastern Underwriters* days by ensuring that the States could continue to regulate and tax

insurance companies. The Court has accordingly held that the Act should "be read as protecting the right of the States to regulate what they traditionally regulated." *Group Life & Health Ins. Co.* v. *Royal Drug Co.*, 440 U.S. 205, 218 (1979). That reading of McCarran-Ferguson precludes assumption of State control over the question whether federal claims are superior to the claims of other creditors in dissolution proceedings.

Prior to the Court's decision in *South-Eastern Underwriters*, it was well established that the federal priority statute applied in state proceedings to liquidate insolvent insurance companies and preempted inconsistent state law. *United States* v. *Knott*, 298 U.S. 544 (1936). The federal priority statute was an exercise of Congress's power to establish bankruptcy laws. Consequently, the "business of insurance" should not be construed to displace the supremacy of federal law in resolving the priority of the United States' claims against a defunct insurance company. That subject was not "traditionally regulated" by the States.

ARGUMENT

CLAIMS OF THE UNITED STATES ARE ENTITLED TO FIRST PRIORITY IN A PROCEEDING TO LIQUIDATE AN INSOLVENT INSURANCE COMPANY

A. The Federal Priority Statute Applies to Claims of the United States Against Insolvent Insurance Companies

1. The federal priority statute provides in part that "[a] claim of the United States Government shall be paid first when * * * a person indebted to the Government is insolvent and * * * an act of bankruptcy is committed." 31 U.S.C. 3713(a)(1)(A); App., *infra*, 1a. Congress enacted a federal priority statute in "the earliest days of the Republic" (*United States* v. *Key*, 397 U.S. 322, 324 (1970)), pursuant to the constitutional grant of authority "[t]o establish * * * uniform laws on the subject of Bankruptcies throughout the United States." U.S. Const. Art. I, § 8, Cl. 4. The origins

of the statute "reach back even further into the English common law," under which "the Crown exercised a sovereign prerogative to require that debts owed it be paid before the debts owed other creditors." *United States* v. *Moore*, 423 U.S. 77, 80 (1975). See 33 Hen. 8, ch. 39, § 74 (1541); 13 Eliz. 1, ch. 4 (1570).[2]

The first federal priority statute – the fifth statute enacted by the First Congress – applied to debts due to the United States for customs duties. See Act of July 31, 1789, ch. 5, § 21, 1 Stat. 42. In 1797, Congress amended the statute to extend its coverage to any "person hereafter becoming indebted to the United States, by bond or otherwise." Act of Mar. 3, 1797, ch. 20, § 5, 1 Stat. 515. In 1799, Congress further amended the priority statute to provide that the administrator of any insolvent or decedent's estate is personally liable for any amount not paid to the United States because the administrator gave another creditor preference. See Act of Mar. 2, 1799, ch. 22, § 65, 1 Stat. 676; 31 U.S.C. 3713(b). The federal priority statute has remained in force for two centuries. Indeed, "[t]he 1797 and 1799 Acts have survived to this day essentially unchanged." *Moore*, 423 U.S. at 81.[3]

[2] Many of the States assert a similar priority as an incident of sovereignty. See *United States* v. *Moore*, 423 U.S. 77, 80 (1975) (citing *Pauley* v. *California*, 75 F.2d 120, 133 (9th Cir. 1934); *People* v. *Farmers' State Bank*, 167 N.E. 804 (Ill. 1929); *In re Carnegie Trust Co.*, 99 N.E. 1096, 1098-1099 (N.Y. 1912); *State* v. *Bank of Maryland*, 26 Am. Dec. 561 (Md. 1834)).

[3] In 1978, Congress amended the federal priority statute to make clear that it does not apply in proceedings under the federal Bankruptcy Code. See Act of Nov. 6, 1978, Pub. L. No. 95-598, § 322(a), 92 Stat. 2678. Similarly, the federal Bankruptcy Code does not apply to insurance companies. See 11 U.S.C. 109(b)(2), 109(d). Accordingly, the provisions of the Bankruptcy Code establishing the priority of claims of the United States in bankruptcy proceedings under Title 11 do not "eliminate, either partially or wholly, the priority of claims of the United States in non-bankruptcy proceedings." *United States* v. *Emory*, 314 U.S. 423, 427 (1941).

In 1982, Congress revised the federal priority statute as part of a general recodification of Title 31. See Act of Sept. 13, 1982, Pub. L. No. 97-258, § 3713, 96 Stat. 972. The 1982 revision was not intended to make any substantive change in the statute. See H.R. Rep. No. 651, 97th Cong., 2d Sess. 1, 3-4, 134 (1982).

The purpose of the federal priority statute is to "secure an adequate revenue to sustain the public burdens, and discharge the public debts." ***United States* v. *State Bank***, 31 U.S. (6 Pet.) 29, 35 (1832). See ***Moore***, 423 U.S. at 82; ***King* v. *United States***, 379 U.S. 329 (1964). That purpose is fundamental to the success of the national government. Accordingly, "it is established that the terms of [the priority statute] are to be liberally construed to achieve [its] broad purpose." ***Key***, 397 U.S. at 324 (citing ***Bramwell* v. *United States Fidelity & Guaranty Co.***, 269 U.S. 483, 487 (1926); ***Beaston* v. *Farmers' Bank***, 37 U.S. (12 Pet.) 102, 134 (1838)).

The Ohio priority statute ranks claims of the United States behind several other classes of claims against insolvent insurance companies, including claims of general business creditors. Similar priority statutes enacted by other States also subordinate claims of the United States to other claims.[4]

[4] The state priority statutes at issue in *Gordon* and *Soward* provide additional examples. See Md. Ins. Code Ann. §§ 158-158A (1991) (assigning fourth priority to claims of the United States as policyholder); Idaho Code § 41-3342 (Supp. 1990) (assigning fifth priority to claims of the United States). See also Uniform Insurers Liquidation Act §§ 6-8, 13 U.L.A. 321-353 (1986); National Association of Insurance Commissioners, Insurers' Supervision, Rehabilitation, and Liquidation Model Act § 42 (1979).

In the courts below, the government argued that even if the Ohio statute governs the priority of claims of the United States, the government's claims are entitled to third priority under the Ohio statute as policyholders' claims. The courts below did not address that argument.

Under the state priority statutes, the United States would often recover little or nothing on claims – including tax claims – against insolvent insurers. The effect on the federal revenue would be significant. Nearly $11 million is at stake in this case alone. The amount of revenue at issue has increased as the rate of insurance company insolvencies has increased. See generally Staff of House Comm. on Energy and Commerce, 101st Cong., 2d Sess., *Failed Promises: Insurance Company Insolvencies* 2 (Comm. Print 1990) (noting that nearly half of 150 property-casualty insurance company insolvencies since 1969 occurred within the last five years, and that insurance company assessments to cover the costs of insolvencies totalled $900 million in 1987, nearly half the total assessments of $2.2 billion for the period from 1969 to 1987).

2. The federal priority statute, by its terms, applies to the claims at issue in this case. Those claims plainly are "claims of the United States Government." In addition, an Ohio court has determined that ADIC is insolvent, has ordered that ADIC be liquidated, and has appointed respondent to serve as liquidator. "The appointment of a receiver under such circumstances is among the most common examples of an 'act of bankruptcy.' " *United States* v. *Emory,* 314 U.S. 423, 426 (1941). Accordingly, the federal priority statute applies to the government's claims – and preempts inconsistent state law – unless the McCarran-Ferguson Act, 15 U.S.C. 1012, requires a different result. See *Florida Lime & Avocado Growers, Inc.* v. *Paul,* 373 U.S. 132, 142-143 (1963).

See Pet. App. 23a (court of appeals remands for entry of judgment "pursuant to Ohio law"); *id.* at 45a (district court "need not address the arguments of the parties as to the priority given to the claims of the federal government under Ohio Rev. Code § 3903.42").

B. A State Statute Establishing the Priority of Claims Against An Insolvent Insurance Company Is Not a Law "Regulating the Business of Insurance"

The McCarran-Ferguson Act provides that "[n]o Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance * * * unless such Act specifically relates to the business of insurance." 15 U.S.C. 1012(b); App., *infra,* 2a. This Court described the narrow reach of that clause in *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 459-460 (1969), stating that McCarran-Ferguson

> did not purport to make the States supreme in regulating all the activities of insurance *companies*; its language refers not to the person or companies who are subject to state regulation, but to laws "regulating the *business* of insurance." Insurance companies may do many things which are subject to paramount federal regulation; only when they are engaged in the "business of insurance" does the statute apply.

Consistent with that reading of the language, this Court has repeatedly held that federal law governs the propriety of a variety of corporate activities conducted by insurance companies. See *Union Labor Life Ins. Co.* v. *Pireno,* 458 U.S. 119 (1982) (insurer's use of peer review committee to determine whether particular charges are covered by an insurance policy is not the business of insurance); *Royal Drug,* 440 U.S. at 230 n.38 (holding that price agreements between insurers and pharmacies are not the business of insurance and observing that among the "aspects of insurance companies [that] are regulated by state law, but are not the 'business of insurance,' " are "the composition of their boards of directors, when their books and records could be inspected, how they could invest their funds, [and] when they could liquidate or merge"); *SEC* v.

National Securities, Inc., supra (state regulation of an insurance company merger is not the business of insurance).

The state law at issue here purports to eviscerate the superiority of the federal government's claims to the proceeds derived from liquidation of a defunct insurance company. The plain language of McCarran-Ferguson demonstrates that such a statute does not regulate the "business of insurance."

1. "[T]he starting point in a case involving construction of the McCarran-Ferguson Act, like the starting point in any case involving the meaning of a statute, is the language of the statute itself." *Royal Drug*, 440 U.S. at 210. See also *St. Paul Fire & Marine Ins. Co.* v. *Barry*, 438 U.S. 531, 541 (1978). McCarran-Ferguson provides that no Act of Congress shall preempt a state statute "enacted * * * for the purpose of regulating the business of insurance," unless the federal law "specifically relates to the business of insurance." 15 U.S.C. 1012(b). The Ohio priority statute cannot reasonably be viewed as a law "enacted * * * for the purpose of regulating the business of insurance."

Ohio's priority statute does not regulate the terms of insurance policies, the selling and advertising of insurance, or any other commercial activity of insurers. Indeed, the statute is not even addressed to insurance companies. Instead, the statute is a bankruptcy law directed at the "estate" of the company (Ohio Rev. Code Ann. § 3903.42 (Anderson 1989)). It comes into play only when an insolvent insurance company's business has been wound up and its assets are distributed among its creditors. At that point, "[t]he only 'business' being conducted is the liquidation of a corporation which happens to have been an insurance company." *Idaho ex rel. Soward* v. *United States*, 858 F.2d at 452. The priority statute addresses the liquidator rather than the insurer, and instructs him to pay out the assets of the insolvent company to its creditors in the order of their priority. See *ibid.* (state priority statute speaks to "the relationship between the insureds [and other creditors] and the government official charged with overseeing the liquidation of the insolvents.").[5] Regulation of the final distribution of liquidated assets—like regulation of when an insurance company may "liquidate or merge"—is an "aspect[ ] of insurance companies [that is] regulated by state law, but [is] not the 'business of insurance.' " *Royal Drug*, 440 U.S. at 230 n.38.

In *Pireno* and *Royal Drug*, the Court considered whether particular practices of insurance companies conducted in the ordinary course of their ongoing business operations were part of "business of insurance" under McCarran-Ferguson. In holding that the practices in issue were subject to paramount federal regulation, the Court developed a three-factor inquiry focusing on the nature of the insurance company practice at issue. See *Pireno*, 458 U.S. at 129. Because the Ohio priority statute does not address insurance companies or activities conducted in the ordinary course of their business, it plainly was not enacted for the purpose of regulating the business of insurance. Consequently, resort to the three-part *Pireno* test is unnecessary to resolve any ambiguity in the application of McCarran-Ferguson to this

---

[5] The court of appeals believed that the priority statute regulates the business of insurance because "[o]nce an insurer is placed in receivership, only the sale of new policies is suspended during liquidation; the actual adjustment of claims and the payment of existing claims continue." Pet. App. 22a. The court of appeals' argument is a non sequitur. Although an insurance company that has been declared insolvent and placed under the control of a liquidator may continue to engage in aspects of the business of insurance during the liquidation, it does not follow that every state statute regulating the liquidation process is a statute "enacted * * * for the purpose of regulating the business of insurance."

statute.[6]

2. In any event, application of the tripartite *Pireno* test likewise leads to the conclusion that the Ohio priority statute does not regulate the business of insurance. *Pireno* considers: "*first,* whether the practice has the effect of transferring or spreading a policyholder's risk; *second,* whether the practice is an integral part of the policy relationship between the insurer and the insured; and *third,* whether the practice is limited to entities within the insurance industry." *Pireno,* 458 U.S. at 129. Applying those factors, *Pireno* held that an insurer's use of a peer review committee in the ordinary course of business to determine whether certain chiropractic charges were covered by the insurance policy was not part of the business of insurance. Given that result, it would be anomalous to hold that rules governing a liquidator's distribution of assets to creditors in dissolution proceedings—rules that do not concern whether the policyholder has a contractual right to recover, or whether a particular claim is within the limits of the policy—are never-

[6] Ohio law itself appears to recognize a distinction between determining the priority of creditors' claims and regulating the business of insurance. The Ohio Code provides, in part:

> The purpose of sections 3903.01 to 3903.59 of the Revised Code is the protection of the interests of insureds, claimants, creditors, and the public generally, with minimum interference with the normal prerogatives of the owners and managers of insurers, through all of the following:
>
> * * * * *
>
> (4) Equitable apportionment of any unavoidable loss;
>
> * * * * *
>
> (6) Regulation of the insurance business by the impact of the law relating to delinquency procedures and substantive rules on the entire insurance business.

Ohio Rev. Code Ann. § 3903.02(D) (Anderson 1989).

theless part of the "business of insurance." Moreover, consideration of each *Pireno* factor confirms that Ohio's statute does not regulate "the business of insurance." [7]

a. "The primary elements of an insurance contract are the spreading and underwriting of a policyholder's risk." *Royal Drug,* 440 U.S. at 211. Indeed, the Court has recognized that the spreading and underwriting of risk are "indispensable characteristic[s] of insurance." *Pireno,* 458 U.S. at 127 (citing *Royal Drug,* 440 U.S. at 212). See also 1 G. Couch, *Cyclopedia of Insurance Law* § 1.3 (2d ed. 1984) ("It is characteristic of insurance that a number of risks are accepted, some of which will involve losses, and that such losses are spread over all the risks so as to enable the insurer to accept each risk at a slight fraction of the possible liability upon it."); R. Keeton, *Insurance Law* § 1.2(a) (1971) ("Insurance is an arrangement for transferring and distributing risk.").[8]

[7] As the court of appeals recognized (Pet. App. 11a), the *Pireno* test is not limited to cases involving the antitrust laws. See *Pilot Life Ins. Co.* v. *Dedeaux,* 481 U.S. 41 (1987) (applying *Pireno* in ERISA context) *Metropolitan Life Ins. Co.* v. *Massachusetts,* 471 U.S. 724 (1985) (same). *Pireno* and *Royal Drug,* in turn, relied on cases involving the federal securities laws. See *SEC* v. *National Securities, Inc.,* 393 U.S. 453 (1969); *SEC* v. *Variable Annuity Life Ins. Co. of America,* 359 U.S. 65 (1959).

[8] Risk-shifting (or underwriting) and risk-spreading (or risk distribution) are distinct concepts. "Shifting risk entails the transfer of the impact of a potential loss from the insured to the insurer." *Clougherty Packing Co.* v. *Commissioner,* 811 F.2d 1297, 1300 (9th Cir. 1987). Risk spreading entails "[i]nsuring many independent risks in return for numerous premiums. * * * By assuming numerous relatively small, independent risks that occur randomly over time, the insurer smoothes out losses to match more closely its receipt of premiums." *Ibid;* see also *Royal Drug,* 440 U.S. at 211-212. Both risk shifting and risk spreading are essential characteristics of insurance. See *Helvering* v. *La Gierse,* 312 U.S. 531, 539 (1941) ("Historically and commonly insurance involves risk-shifting and risk-distributing. * * * That these elements * * * are essential to a life insurance contract is agreed by courts and commentators.").

In *SEC* v. *Variable Annuity Life Ins. Co. of America*, 359 U.S. 65, 71 (1959), the Court held that variable annuity contracts are not insurance because they "place[ ] all the investment risk on the annuitant and none on the company." *Royal Drug*, 440 U.S. at 212. "Central to the Court's holding" in the *Variable Annuity* case was the principle that "the concept of 'insurance' involves some investment risk-taking on the part of the company." *Royal Drug*, 440 U.S. at 212 (quoting *Variable Annuity Life Ins. Co. of America*, 359 U.S. at 71). Because variable annuities involved "no true underwriting of risks," the Court concluded that they lacked "the one earmark of insurance as it has commonly been conceived of in popular understanding and usage." 359 U.S. at 73.

The Ohio priority statute does not result in any underwriting or investment risk-taking by the insurance company. The policyholders and other creditors of an insurance company, rather than the insurance company, bear the risk that their claims will not be paid if the company becomes insolvent. This risk of nonpayment arising out of a default by a debtor is common to a multitude of contractual arrangements; it is not in any way an essential characteristic of the "business of insurance." The Ohio statute merely determines the priority of the creditors' claims in the event the company is liquidated. The statute thus does not regulate the "true underwriting of risks, the one earmark of insurance." *Variable Annuity Life Ins. Co. of America*, 359 U.S. at 73.

The Court's discussion of risk transfer in *Pireno* confirms that the State's assignment of priority to claims against an insolvent insurer does not involve any such transfer. In *Pireno*, the Court explained that "[t]he transfer of risk from insured to insurer is effected by means of the contract between the parties – the insurance policy – and that transfer is complete at the time that the contract is entered." 458 U.S. at 130. The Court concluded that the use of peer review to determine whether a particular claim fell within the limits of an insurance policy "is logically and temporally unconnected to the transfer of risk accomplished by [the] insurance policies." *Ibid.* The Court rejected the view that "the transfer of risk from an insured to his insurer actually takes place not when the contract between those parties is completed, but rather only when the insured's claim is settled." *Id.* at 131. The Court observed that such a view "is contrary to the fundamental principle of insurance that the insurance policy defines the scope of the risk assumed by the insurer from the insured." *Ibid.* The Ohio priority statute, like the peer review process at issue in *Pireno*, is "logically and temporally unconnected to the transfer of risk accomplished by [the] insurance polic[y]." *Ibid.* The risk of insurer insolvency is not a risk covered by the insurance policy. Consequently, there is no transfer of the risk of insurer insolvency from insured to insurer when at the time the parties enter the insurance contract – or, indeed, at any time.[9]

b. In addition, the Ohio priority statute is not integral to the contractual relationship between the insurance company and the insured. The Ohio statute plainly does not regulate the contract of insurance itself. And it is not the case that the Ohio statute "so closely affect[s] the 'reliability, interpretation, and enforcement' of the insurance contract * * * as to fall within the exempted area." *Royal Drug*, 440 U.S. at 216. The statute has nothing to do with whether the policyholder has a valid contractual claim against the

[9] Nor does the priority statute involve risk spreading – that is, the assumption of "numerous relatively small, independent risks that occur randomly over time" in return for numerous premiums. *Clougherty Packing Co.*, 811 F.2d at 1300. Each creditor faces the risk that the insurance company will become insolvent; thus, the risks are not independent, and losses due to insolvency do not occur randomly over time. Rather than spreading risk, the priority statute merely determines the order in which creditors' claims will be paid.

insurer. Rather, the statute comes into play only in the event that the insurance company becomes insolvent and is liquidated. At that point, there is no longer a relationship between the policyholder and there is nothing the liquidator "could do to make the defunct entity a reliable insurer." *Idaho ex rel. Soward* v. *United States*, 858 F.2d at 453. Indeed, the Ohio priority statute does not even address the relationship between the insurance company and the insured. Instead, it addresses the relationship between policyholders and other creditors of insolvent insurance companies. See *id.* at 454 (priority statute "address[es] * * * the relationship [among] those left in the lurch by the expiration of the insurer").

To be sure, the Ohio priority statute affects the risk that a policyholder's claims will not be paid in the event the insurance company becomes insolvent. But as the Court observed in *Royal Drug*, an argument that such an effect is sufficient to bring the statute within the McCarran-Ferguson Act exemption "proves too much." 440 U.S. at 216. Virtually all government regulation of insurance companies has some impact on a policyholder's risk of nonpayment. For example, regulation of the cost-cutting measures at issue in *Royal Drug*, and the peer review system at issue in *Pireno*, affected insurer costs, and therefore the risk that the insurer would be unable to pay claims. As the Court noted in *Royal Drug*, "[m]any aspects of insurance companies are regulated by state law, but are not the 'business of insurance.' " 440 U.S. at 230 n.38 (citing as examples "how [insurance companies] could invest their funds, when they could liquidate or merge, as well as how they could purchase goods and services"). Consequently, the Ohio statute is properly viewed as one of many state laws applicable to insurance companies that are not integral to the contractual relationship, even though they may affect the probability that future policyholder claims will be paid.

c. The Ohio priority statute plainly is not limited to entities in the insurance industry. As the court of appeals recognized (Pet. App. 23a), the statute governs the rights of *all* creditors of insolvent insurance companies, including general business creditors, stockholders, and employees, as well as government entities. Moreover, a priority statute is not a regulation that is peculiar to the business of insurance. Instead, it is a standard feature of bankruptcy laws.

The court of appeals nevertheless concluded that the statute is limited to entities in the insurance industry because it "focus[es]" on the protection of policyholders. *Id.* at 23a. That conclusion is flawed for two reasons. First, the Ohio statute does not "focus" exclusively on the protection of policyholders. It is a comprehensive ordering of all classes of claims against an insolvent insurance company. The Ohio statute itself states expressly that its broad purpose is "the protection of the interests of insureds, claimants, creditors, and the public generally, with minimum interference with the normal prerogatives of the owners and managers of insurers." See Ohio Rev. Code Ann. § 3903.02(D) (Anderson 1989); App., *infra*, 4a. The Ohio statute ranks two classes of claims – administrative expenses and wages – ahead of policyholder claims. See *id.* at 3a-4a. And it ranks claims of general creditors *behind* claims of policyholders but *ahead* of government claims. *Id.* at 4a. A policy of protecting policyholders cannot justify that result.

Second, the relevant question under this Court's decisions is not whether the statute "focus[es]" on policyholders, but whether it is limited to entities within the insurance industry. The Ohio priority statute does not meet the third *Pireno* criterion because, as the court of appeals acknowledged (Pet. App. 23a), it "necessarily involves the claims of non-policied creditors."

In sum, the Ohio priority statute flunks *Pireno*'s three-part test for determining whether a statute regulates the

business of insurance. Accordingly, the federal priority statute governs the priority of claims of the United States against an insolvent insurance company.

C. The Enactment History of McCarran-Ferguson Supports the Conclusion that the Federal Preemption Statute Applies to Claims Against an Insolvent Insurer

This Court's prior decisions construing McCarran-Ferguson have elaborately considered the measure's enactment history. See *Royal Drug*, 440 U.S. at 217-230; *Barry*, 438 U.S. at 546-550; *SEC* v. *National Securities, Inc.*, 393 U.S. at 458-460. In this case, that history strongly reinforces the conclusion that the Ohio priority statute does not regulate the "business of insurance."

1. Congress adopted McCarran-Ferguson in 1945 in response to the Court's decision in *United States* v. *South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944). See *St. Paul Fire & Marine Ins. Co.* v. *Barry*, 438 U.S. 531, 538 (1978). Prior to *South-Eastern Underwriters*, it had been assumed for more than 70 years that "[i]ssuing a policy of insurance is not a transaction of commerce." *Paul* v. *Virginia*, 75 U.S. (8 Wall.) 168, 183 (1868). Because insurance was not viewed as part of interstate commerce, "the States enjoyed a virtually exclusive domain over the insurance industry." *Barry*, 438 U.S. at 539. In *South-Eastern Underwriters*, however, the Court held that insurance transactions are subject to federal regulation under the Commerce Clause, and that Congress did not intend to exempt the business of insurance from the provisions of the Sherman Act. The Court's decision in *South-Eastern Underwriters* "provoked widespread concern that the States would no longer be able to engage in taxation and effective regulation of the insurance industry." *Barry*, 438 U.S. at 539.

Congress reacted swiftly to *South-Eastern Underwriters* by enacting McCarran-Ferguson. The purpose of the Act "was stated quite clearly in its first section; Congress declared that 'the continued regulation and taxation by the several States of the business of insurance is in the public interest.' " *National Securities*, 393 U.S. at 458 (quoting 15 U.S.C. 1011). The Act was thus "an attempt to turn back the clock" to pre-*South-Eastern Underwriters* days. *National Sec.*, 393 U.S. at 459. See *FTC* v. *Travelers Health Ass'n*, 362 U.S. 293, 299 (1960). As the House Report stated:

> It [was] not the intention of Congress in the enactment of this legislation to clothe the States with any power to regulate or tax the business of insurance beyond that which they had been held to possess prior to the decision of the United States Supreme Court in the *Southeastern Underwriters Association* case.

H.R. Rep. No. 143, 79th Cong., 1st Sess. 3 (1945). See also 90 Cong. Rec. 6524 (1944) (statement of Rep. Walter) ("[T]he legislation * * * is designed to restore to the status quo the position the insurance business of this Nation occupied before the Supreme Court recently legislated [in *South-Eastern Underwriters*]."). Accordingly, "[t]he McCarran-Ferguson Act should be read as protecting the right of the States to regulate what they traditionally regulated." *Royal Drug*, 440 U.S. at 218 n.18.[10] The Act is thus addressed to the distribution, between the States and the federal government, of power to tax and regulate commerce consisting of the business of insurance – not to the long-

---

[10] To be sure, McCarran-Ferguson did not simply overrule the Court's decision in *South-Eastern Underwriters*. Prior to *South-Eastern Underwriters*, insurance company boycotts, coercion, and intimidation did not violate the federal antitrust laws, because insurance was not thought to be part of interstate commerce. For the same reason, it was thought that Congress lacked power to regulate the business of insurance, and therefore federal laws did not apply to the business of insurance even in the absence of state regulation. See *Royal Drug*, 440 U.S. at 220 & n.24; *id.* at 205, 237-238 & n.4 (Brennan, J., dissenting); see 91 Cong. Rec. 478 (1945). Although McCarran-Ferguson thus departed from pre-

standing authority of the federal government to adopt rules pursuant to its power under the Bankruptcy Clause.

This reading of McCarran-Ferguson strongly reinforces the conclusion that the Ohio statute does not regulate the "business of insurance" because the States did not "traditionally" have "the right * * * to regulate" the priority of United States' claims in insurance liquidation proceedings. Construing McCarran-Ferguson to preclude application of the federal priority statute to federal claims against an insolvent insurer would "clothe the States with * * * power to regulate * * * the business of insurance beyond that which they had been held to possess prior to the decision of the United States Supreme Court in the *Southeastern Underwriters Association* case." H.R. Rep. No. 143, *supra*, at 3.

Prior to *South-Eastern Underwriters*, the Court held in *United States* v. *Knott*, 298 U.S. 544 (1936), that the federal insolvency statute applied in state court proceedings to liquidate an insolvent insurance company and preempted a state statute that provided for repayment of in-state creditors ahead of all other creditors. In *Knott*, the United States filed a claim for payment of judgments on bail bonds, and asserted that its claim was entitled to first priority under the federal priority statute. Despite the conflicting Florida statute, the Court concluded "that the claim presented is, in its nature, one entitled to priority." 298 U.S. at 548.[11]

South-Eastern Underwriters law in some respects, those differences are not relevant in this case.

[11] Prior to *South-Eastern Underwriters*, state courts also considered the applicability of the federal priority statute in insurance company insolvency proceedings, and held or assumed that the federal statute applied to claims of the United States. See *In re Casualty Co. of America*, 196 A.D. 175, 176-177 (1st Dep't), aff'd, 232 N.Y. 559, 561 (1921); *People* v. *Metropolitan Surety Co.*, 161 N.Y.S. 616 (1916). See also *Conway* v. *Imperial Life Ins. Co.*, 21 So. 2d 151 (La. 1945); *Fred L. Emmons, Inc.* v. *Union Indemnity Co.*, 175 A. 141 (N.J. 1934). State courts reached the same result following passage of the McCarran-

The court of appeals' efforts to distinguish *Knott* are unpersuasive. The court observed that "McCarran-Ferguson did not return to the *status quo* prior to *South-Eastern Underwriters*; instead, it only permitted state regulation of the 'business of insurance' without federal interference." Pet. App. 14a (citing *Royal Drug*, 440 U.S. at 220 n.24). But as we have explained, see note 9, *supra*, the differences between McCarran-Ferguson and the law prior to *South-Eastern Underwriters* do not affect the application of the federal priority statute to claims against insolvent insurers. Moreover, the court of appeals' reliance on *Royal Drug* is misplaced. The passage cited by the court of appeals concluded only that McCarran-Ferguson "embod[ies] a legislative rejection of the concept that the insurance industry is outside the scope of the antitrust laws – a concept that had prevailed before the *South-Eastern Underwriters* decision." 440 U.S. at 220. The Court thus recognized in *Royal Drug* that McCarran-Ferguson did not restore all of the regulatory authority that the States had enjoyed prior to *South-Eastern Underwriters*; the Court did not suggest that McCarran-Ferguson granted the States additional regulatory authority beyond that which they had "traditionally" possessed. 440 U.S. at 218 n.18.

The court of appeals also sought to distinguish *Knott* on the ground that "the Florida statute at issue in *Knott* contained only generalized provisions protecting domestic creditors in Florida insurance companies over foreign creditors; it in no way regulated the 'business of insurance' for the protection of the insured." Pet. App. 14a. But the Florida statute at issue in *Knott*, like the Ohio statute in

---

Ferguson Act. See *In re Union Indemnity*, 551 N.Y.S.2d 446 (Sup. Ct. 1990), aff'd *sub nom. Curiale* v. *United States*, 566 N.Y.S.2d 853 (App. Div. 1991), petition for cert. pending, No. 91-1347; *Langdeau* v. *United States*, 363 S.W.2d 327 (Tex. Civ. App. 1962).

this case, addressed the claims of all creditors of an insolvent insurance company. Moreover, the Florida statute, as interpreted by the Florida courts, entitled "obligees on Florida surety bonds and surety contracts" (*i.e.*, policyholders) "to preferential payment in advance of other claims of a subordinate order, such as claims of Florida creditors in general." *Kelly* v. *Knott*, 163 So. 64, 68 (Fla. 1935). Accordingly, the "focus" of the Florida statute at issue in *Knott* was not significantly different from the "focus" of the Ohio priority statute in this case.

2. Consideration of McCarran-Ferguson's broader purposes leads to the same conclusion. "The primary concern of Congress in the wake of [*South-Eastern Underwriters*] was in enacting legislation that would ensure that the States would continue to have the ability to tax and regulate the business of insurance." *Royal Drug*, 440 U.S. at 217-218. As the Court has explained, "[t]he problem was that if insurance was interstate commerce, then the constitutionality of state regulation and taxation would be questionable." *Id.* at 218 n.16 (citing S. Rep. No. 20, 79th Cong., 1st Sess. 2 (1945); H.R. Rep. No. 143, 79th Cong., 1st Sess. (1945)). The issue in this case is simply whether the federal priority statute, implementing the longstanding congressional power to establish bankruptcy laws, applies to claims of the United States against insolvent insurance companies. Resolution of that narrow issue in favor of the United States will not call into question the States' broad authority to tax and regulate the business of insurance or the distribution of power to tax and regulate commerce effected by the McCarran-Ferguson Act.

Finally, the Court has recognized that an additional concern of Congress in enacting McCarran-Ferguson "was the applicability of the antitrust laws to the insurance industry." *Royal Drug*, 440 U.S. at 218. The antitrust exemption was directed primarily at cooperative ratemaking, "[b]ecause of the widespread view that it is very difficult to underwrite risks in an informed and responsible way without intra-industry cooperation." *Id.* at 221. See also *Pireno*, 458

U.S. at 133. Neither the antitrust laws nor cooperative ratemaking are at issue here. Accordingly, application of the federal priority statute to claims of the United States against an insolvent insurance company is consistent with the purposes of the McCarran-Ferguson Act.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

KENNETH W. STARR
Solicitor General

STUART M. GERSON
Assistant Attorney General

MAUREEN E. MAHONEY
Deputy Solicitor General

ROBERT A. LONG, JR.
Assistant to the Solicitor General

WILLIAM KANTER
JENNIFER H. ZACKS
Attorneys

JULY 1992

APPENDIX

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

1. Article VI of the United States Constitution provides, in part: "[T]he Laws of the United States * * * shall be the supreme Law of the Land."

2. The federal priority statute, 31 U.S.C. 3713, provides:

Priority of Government claims

(a)(1) A claim of the United States Government shall be paid first when –

(A) a person indebted to the Government is insolvent and –

(i) the debtor without enough property to pay all debts makes a voluntary assignment of property;

(ii) property of the debtor, if absent, is attached; or

(iii) an act of bankruptcy is committed; or

(B) the estate of a deceased debtor, in the custody of the executor or administrator, is not enough to pay all debts of the debtor.

(2) This subsection does not apply to a case under title 11.

(b) A representative of a person or an estate (except a trustee acting under title 11) paying any part of a debt of the person or estate before paying a claim of the Government is liable to the extent of the payment for unpaid claims of the government.

3. The McCarran-Ferguson Act, 15 U.S.C. 1011-1012, provides in part:

§ 1011. Declaration of policy

Congress hereby declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.

§ 1012. Regulation by state law; Federal law relating specifically to insurance; applicability of certain Federal laws after June 30, 1948

(a) **State regulation**

The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

(b) **Federal regulation**

No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance * * * unless such Act specifically relates to the business of insurance.

4. The Ohio Insurers Supervision, Rehabilitation and Liquidation Act, Ohio Rev. Code Ann. §§ 3903.02(D) and 3903.42 (Anderson 1989) provides:

§ 3903.42 Priority of distribution of claims.

The priority of distribution of claims from the insurer's estate shall be in accordance with the order in which each class of claims is set forth in this section. Every claim in each class shall be paid in full or adequate funds retained for such payment before the members of the next class receive any payment. No subclasses shall be established within any class. The order of distribution of claims shall be:

(A) Class 1. The costs and expenses of administration, including but not limited to the following:

(1) The actual and necessary costs of preserving or recovering the assets of the insurer;

(2) Compensation for all services rendered in the liquidation;

(3) Any necessary filing fees;

(4) The fees and mileage payable to witnesses;

(5) Reasonable attorney's fees;

(6) The reasonable expenses of a guaranty association or foreign guaranty association in handling claims.

(B) Class 2. Debts due to employees for services performed to the extent that they do not exceed one thousand dollars and represent payment for services performed within one year before the filing of the complaint for liquidationn. Officers and directors shall not be entitled to the benefit of this priority. Such priority shall be in lieu of any other similar priority that may be authorized by law as to wages or compensation of employees.

(C) Class 3. All claims under policies for losses incurred, including third party claims, all claims against the insurer for liability for bodily injury or for injury to or destruction of tangible property that are not under policies, and all claims of a guaranty association or foreign guaranty association. All claims under life insurance and annuity policies, whether for death proceeds, annuity proceeds, or investment values, shall be treated as loss claims. That portion of any loss, indemnification for which is provided by other benefits or advantages recovered by the claimant, shall not be included in this class, other than benefits or advantages recovered or recoverable in discharge of familial obligations of support or by way of succession at death or as proceeds of life insurance, or as gratuities. No pay-

ment by an employer to an employee shall be treated as a gratuity. Claims under nonassessable policies for unearned premium or other premium refunds.

(D) Class 4. Claims of general creditors.

(E) Class 5. Claims of the federal or any state or local government. Claims, including those of any governmental body for a penalty or forfeiture, shall be allowed in this class only to the extent of the pecuniary loss sustained from the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby. The remainder of such claims shall be postponed to the class of claims under division (H) of this section.

(F) Class 6. Claims filed late or any other claims other than claims under divisions (G) and (H) of this section.

(G) Class 7. Surplus or contribution notes, or similar obligations, and premium refunds on assessable policies. Payments to members of domestic mutual insurance companies shall be limited in accordance with law.

(H) Class 8. The claims of shareholders or other owners.

§ 3903.02 Citation, construction and purpose of act.

(D) The purpose of sections 3903.01 to 3903.59 of the Revised Code is the protection of the interests of insureds, claimants, creditors, and the public generally, with minimum interference with the normal prerogatives of the owners and managers of insurers, through all of the following:

(1) Early detection of any potentially dangerous condition in an insurer, and prompt application of appropriate corrective measures;

(2) Improved methods for rehabilitating insurers, involving the cooperation and management expertise of the insurance industry;

(3) Enhanced efficiency and economy of liquidation, through clarification of the law, to minimize legal uncertainty and litigation;

(4) Equitable apportionment of any unavoidable loss;

(5) Lessening the problems of interstate rehabilitation and liquidation by facilitating cooperation between states in the liquidation process, and by extending the scope of personal jurisdiction over debtors of the insurer outside this state;

(6) Regulation of the insurance business by the impact of the law relating to delinquency procedures and substantive rules on the entire insurance business.

No. 91-1513

IN THE

Supreme Court of the United States

October Term, 1992

UNITED STATES DEPARTMENT OF THE TREASURY AND MITCHELL A. LEVINE, ASSISTANT COMMISSIONER,
Petitioners,

vs.

GEORGE FABE, SUPERINTENDENT OF INSURANCE, STATE OF OHIO,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR RESPONDENT

JAMES R. RISHEL
Counsel of Record
DAVID A. KOPECH
ZACHARY T. DONOVAN
RISHEL, MYERS & KOPECH
280 North High Street
Suite 800
Columbus, Ohio 43215
(614) 221-0717
Counsel for Respondent

Of Counsel:
LEE I. FISHER
Attorney General of Ohio

THE GATES LEGAL PUBLISHING CO., CLEVELAND, OHIO—TEL. (216) 621-4647

TABLE OF CONTENTS

APPENDIX:

TABLE OF AUTHORITIES

Cases:

Statutes:

Miscellaneous:

No. 91-1513

IN THE

Supreme Court of the United States

October Term, 1992

UNITED STATES DEPARTMENT OF THE TREASURY AND MITCHELL A. LEVINE, ASSISTANT COMMISSIONER,
Petitioners,

vs.

GEORGE FABE, SUPERINTENDENT OF INSURANCE, STATE OF OHIO,
Respondent.

On Writ of Certiorari To the United States Court of Appeals For the Sixth Circuit

BRIEF FOR RESPONDENT

STATUTORY PROVISIONS INVOLVED

In addition to the statutes cited by the Petitioners, 11 U.S.C. §109(b)(2) and the following provisions of the Ohio's Insurers Supervision, Rehabilitation and Liquidation Act, Ohio Rev. Code Ann. Chapter 3903 (Anderson 1989) are important to a consideration of the question presented by the Petitioners: Ohio Rev. Code Ann. §§3903.03, 3903.17(C), 3903.18(A), 3903.21(A)(6), 3903.21(A)(12), 3903.32, 3903.33, 3903.43, and 3903.44 (see Appendix).

SUMMARY OF ARGUMENT

Ohio Rev. Code Ann. §3903.42 (Anderson 1989), which determines the priority of all claims filed in a proceeding to liquidate an insolvent Ohio insurance company, is a law enacted by the Ohio General Assembly for the purpose of regulating the "business of insurance." The paramount goal of the liquidation process is the payment of policyholder claims. The achievement of that goal underlies the entire liquidation process and is only realized if the priority of payment provisions of Ohio law are undisturbed. In reality, the liquidation of an insolvent insurer is the **ultimate** regulation of the business of insurance by a state under the authority granted by the McCarran-Ferguson Act. 15 U.S.C. §1011, *et seq.* (1988).

The court of appeals correctly recognized that Ohio Rev. Code Ann. §3903.42 "is part and parcel of a large, complex and specialized administrative system adopted by the State of Ohio to regulate the life of domestic insurance companies from inception to dissolution pursuant to McCarran-Ferguson." *Fabe v. United States Dept. of Treasury*, 939 F.2d 341, 347 (6th Cir. 1991). The Petitioners would transform this "complex and specialized administrative system" of regulation of the dissolution of an Ohio insurance company into a claims collection process for the primary benefit of the federal government. Pursuant to the McCarran-Ferguson Act, the priority of the federal government's claim in the liquidation of American Druggists' Insurance Company is to be determined by the Ohio statute not by 31 U.S.C. §3713, the federal priority statute.

The McCarran-Ferguson Act provides that "[n]o Act of Congress shall be construed to invalidate, impair or supercede any law enacted by a state for the purpose of

regulating the business of insurance ... unless the Act specifically relates to the business of insurance." 15 U.S.C. §1012(b).[1] Applying the plain language of the Act and the Court's prior decisions involving the phrase "business of insurance" to Ohio Rev. Code Ann. §3903.42 demonstrates that Ohio's priority statute clearly regulates the "business of insurance."

The plain language of the McCarran-Ferguson Act precludes application of the federal priority statute to the claims filed by the federal government in the Ohio insurance insolvency proceeding. 31 U.S.C. §3713 does not specifically relate to the "business of insurance." Nor did Congress expressly provide by inclusion of the statute in the exceptions to the McCarran-Ferguson Act or through amendment to the federal priority statute that it applies to state insurance insolvencies.[2] The

[1] Before the district court, both parties stipulated that Ohio Rev. Code Ann. §3903.42 is a state law which regulates the insurance industry, that application of the federal priority statute would "invalidate, impair or supersede" the state statute, and that the federal priority statute is not an act which specifically relates to the "business of insurance." 939 F.2d 341, 343.

[2] Senator Ferguson expressly stated that the McCarran-Ferguson Act applied to all federal statutes in existence at that time:

> MR. MURDOCK. I invite the Senator's attention to paragraph (b) of section 2 of the bill, reading as follows:
>
> "(b) No act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such act specifically so provides."
>
> That part of the bill is applicable, is it not to Federal statutes now in existence?
>
> MR. FERGUSON. That is the purpose of the section.

91 Cong. Rec. 479 (1945).

primary purpose of state insurance liquidation proceedings is the payment of claims made against policies. The state priority statute preserves this essential claim payment function and clearly regulates the "business of insurance."

An identical conclusion results from application of the analysis developed by this Court in *SEC v. National Securities, Inc.*, 393 U.S. 453 (1969); *Group Life and Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205 (1979); and *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982). Ohio's insurance insolvency statutes regulate the core elements of the "business of insurance": the relationship between insurer and insured and the reliability, interpretation and enforcement of the policy entered by them. The Ohio statute at issue here satisfies all three of the criteria of the "business of insurance" identified by the Court in *Pireno*.

First, by requiring the insurer's assets to be applied first to a full payment of losses under individual policies, the state statute effectuates on a continuing basis the spreading of the risk of loss among all policyholders by accessing assets of the liquidation estate to pay the losses. Second, the state priority statute effects the essence of the central relationship between the insurer and insured by bolstering the reliability of the contractual relationship (*i.e.*, likelihood of payment). Third, the state statute regulates an insolvent insurer, clearly an entity within the insurance industry.

The enactment history of McCarran-Ferguson also supports the lower court's conclusion that 31 U.S.C. §3713 does not preempt Ohio Rev. Code Ann. §3903.42. Nor does this Court's decision in *United States v. Knott*, 298 U.S. 944 (1936) alter that conclusion as *Knott* did not involve a state insurance claims priority statute.

After applying the plain meaning of McCarran-Ferguson as well as this Court's analysis of the phrase "business of insurance," the court of appeals correctly concluded that Ohio Rev. Code Ann. §3903.42 is "exempt from federal preemption as a regulation of the 'business of insurance' within the McCarran-Ferguson Act." 939 F.2d 341, 352.[3] A reversal of that decision would cause states to question whether difficult time-consuming insurance liquidation proceedings should be conducted at all if the primary and in many instances the sole beneficiary is the federal government. The two federal courts which have addressed the issue subsequent to the Sixth Circuit's decision have recognized its wisdom and adopted its conclusion.[4] Respondent requests the Court to do likewise and affirm the decision of the court of appeals.

[3] The court of appeals also found cases in which district courts had abstained from federal intervention into the complex administrative schemes developed by states for liquidating insolvent insurance companies to be persuasive as to whether state regulation of insurance company insolvencies constitutes the regulation of the business of insurance. 939 F.2d 341, 349, 350.

[4] *Lyons v. United States*, Civil No. 4-91-10209 (S.D. Iowa July 2, 1992) (copy contained in Appendix); *Garcia v. Island Program Designer, Inc.*, 791 F. Supp. 338 (D.P.R. 1992).

ARGUMENT

CLAIMS OF THE UNITED STATES FILED IN AN OHIO INSURANCE INSOLVENCY PROCEEDING ARE ENTITLED TO THE PRIORITY AFFORDED THEM BY OHIO REV. CODE ANN. §3903.42, A LAW REGULATING THE "BUSINESS OF INSURANCE."

By exempting insurance companies from the federal Bankruptcy Code, 11 U.S.C. §109(b)(2), the Congress has explicitly left the exclusive authority to liquidate insolvent insurance companies to the states.[5] Ohio exercises this authority pursuant to, Ohio Rev. Code Ann. Chapter 3903 (Anderson, 1989),[6] which provides the statutory framework for regulation by the Ohio Department of Insurance of insurance companies determined by the Department to be badly managed or financially unsound. The Ohio General Assembly expressed the purpose to be served by the Chapter:

> "The purpose of Sections 3903.01 to 3903.59 of the Revised Code is the protection of the interests of **insureds**, claimants, creditors, and the public generally." (emphasis added).

Ohio Rev. Code Ann. §3903.02(D).

The Chapter empowers the Superintendent of Insurance to place a financially impaired insurance company under supervision, into rehabilitation, or into liquidation. Liquidation is authorized when, in the Superintendent's view, neither supervision nor rehabilitation will remedy the hazard to policyholders and other creditors, the insurer is insolvent, and "further transactions of business would be hazardous, financially or otherwise to its **policyholders**, its creditors, or the public." Ohio Rev. Code Ann. §3903.17(C), (emphasis added). The Superintendent, as liquidator, is authorized to take title to all assets[7]; collect and invest moneys due the insurer[8]; continue to prosecute and commence in the name of the insurer any and all suits or legal proceedings[9]; collect reinsurance and unearned premiums due the insurer[10]; evaluate (*i.e.*, "adjust") all claims against the estate[11]; and make payment to claimants to the extent possible[12]. In short, the Liquidator is empowered to continue to operate the insurance company in all ways except for the issuance of new policies.

Priority of payment to claimants is governed by Ohio Rev. Code Ann. §3903.42. Claimants are divided into eight classes. Each class must be paid in full before

[5] Congress has excluded domestic insurers from federal bankruptcy relief to "preserve the exclusive jurisdiction of the states over the liquidation of insurance companies." *In re Equity Funding Corp. of America*, 396 F. Supp. 1266, 1275 (C.D. Cal. 1975). State liquidation proceedings do not alter the nature of an insurance company or affect its status as a "domestic insurance company" under 11 U.S.C. §109(b)(2). *In re Union Guarantee and Mortgage Co.*, 75 F.2d 983 (2d Cir. 1935); *In re Peoria Life Insurance Co.*, 75 F.2d 777, 778 (7th Cir. 1935); *In re National Surety Co.*, 7 F. Supp. 955, 961 (N.D.N.T. 1934).

Appreciating that the federal government could better bear the loss occasioned by the bankruptcy of a debtor than other creditors, Congress specified that the federal claims priority statute does not apply in bankruptcy proceedings. 31 U.S.C. §3713(a)(2). Petitioners are unable to offer any logical basis for excluding the federal claims priority statute from bankruptcy proceedings but applying it in state insurance insolvency proceedings.

[6] Ohio Revised Code Annotated Title XXXIX [39] (Anderson, 1989) contains the Ohio provisions relating to the business of insurance. Title 39 establishes requirements affecting incorporation of all insurance companies in Ohio, licensing of companies and agents, types of policies and their provisions, valuation of reserves, reporting requirements and rehabilitation, among others. Ohio Revised Code Annotated Chapter 3903 was enacted as part of this complex and specialized administrative system established by the Ohio Legislature in Title 39. All further citations to the Ohio Revised Code are to Ohio Rev. Code Ann. (Anderson, 1989).

[7] Ohio Rev. Code Ann. §3903.18(A).

[8] Ohio Rev. Code Ann. §3903.21(A)(6).

[9] Ohio Rev. Code Ann. §3903.21(A)(12).

[10] Ohio Rev. Code Ann. §§3903.32 and 3903.33.

[11] Ohio Rev. Code Ann. §3903.43.

[12] Ohio Rev. Code Ann. §3903.44.

distributing funds to claimants of a lower class. The first two classes are costs of administering the estate and limited employee wage claims. The third claim consists in principal part of "claims under policies for losses incurred."[13] The fourth class is "[c]laims of general creditors,"[14] and the fifth class is "[c]laims of the federal or any state or local government."[15] The statute evidences a legislative intent to distribute the liquidation estate's assets to individual policyholders in preference to all other creditors, including governmental claimants. Hence, the judgment of the Ohio General Assembly is that enforcement of the policy of insurance is paramount in the liquidation process and claims not based on policy obligations or claims by governmental entities, including the State of Ohio, are to be afforded far less protection.

1. The Plain Language of McCarran-Ferguson Precludes Application of 31 U.S.C. §3713 to Claims Filed by the Federal Government in State Insurance Insolvency Proceedings.

The starting and ending point of consideration of the McCarran-Ferguson Act in this case is the plain language of the statute. *St. Paul Fire and Marine Ins. Co. v. Barry*, 438 U.S. 531, 541 (1978). The Act provides in relevant part, "**[n]o Act of Congress** shall be construed to invalidate, impair or supercede any law enacted by a state for the purpose of regulating the business of insurance . . . unless the Act specifically relates to the business of insurance." 15 U.S.C. §1012(b) (emphasis added). The federal claim priority statute, 31 U.S.C. §3713, does not state that it relates to the "business of insurance" or applies to claims filed by the federal

[13] Ohio Rev. Code Ann. §3903.42(C).
[14] Ohio Rev. Code Ann. §3903.42(D).
[15] Ohio Rev. Code Ann. §3903.42(E).

government in state insurance insolvency proceedings. Nor did Congress expressly include the federal claim priority statute in the exceptions to the McCarran-Ferguson Act. Therefore, the plain language of the McCarran-Ferguson Act precludes application of 31 U.S.C. §3713 to claims filed by the federal government in state insurance insolvency proceedings.

Regarding the plain meaning of McCarran-Ferguson, Petitioners do not understand that the liquidator of an insolvent insurance company performs all functions necessary to conduct the business of insurance. The primary purpose of the insurance liquidation is identical to the primary purpose of a solvent insurance company: payment of claims made against policies. It is the insurer's agreement to pay a covered claim which is being purchased by the policyholder.[16] The adjustment and actual payment of a claim is the essence of the contractual relationship between insurer and insured:

> The key representation of the insurance company and the principal expectation of the policyholder is that prompt payment will be made when the event insured against actually occurs. As one commentator has stated: "Up until the time there is a claim and a payment is made, the only tangible evidence of insurance is a piece of paper. In other words, the real product of insurance is the claims proceeds. Selection of the prospect, qualifying him for coverage that suits his needs, delivery of a policy, collecting premiums for perhaps years, making changes in coverage to meet changing situations, all of these are but preambles to the one purpose for which the insurance was secured,

[16] "In a general sense, 'insurance' is a contract to pay a sum of money upon the happening of a particular event or contingency, or indemnity for loss in respect of a specified subject by specified perils. . . ." 1 G. Couch, *Cyclopedia of Insurance Law* §1:2 (2d ed. 1984).

namely to collect dollars if and when an unforeseen event takes place." J. Wickman, *Evaluating the Health Insurance Risks* 57 (1965).

Union Labor Fire Ins. Co. v. Pireno, 458 U.S. 119, 134 (Rehnquist, dissent).

The lower court correctly held that Ohio Rev. Code Ann. §3903.42 preserves the essential claims payment function of the business of insurance. The court of appeals applied a "test of logic" to conclude that "Ohio Rev. Code Ann. §3903.42 protects the interests of the insured, and therefore is protected from federal preemption as a law regulating the 'business of insurance'," 939 F.2d 341, 350, 351. Pursuant to the plain meaning of the McCarran-Ferguson Act, 31 U.S.C. §3713 is not applicable to state insurance insolvencies and claims filed by the federal government in the liquidation of The American Druggists' Insurance Company should be determined in accordance with the provisions of Ohio Rev. Code Ann. §3903.42.

2. Ohio Rev. Code Ann. §3903.42 Regulates the "Business of Insurance" as Defined by this Court in Cases Interpreting the McCarran-Ferguson Act.

The common theme of this Court's decisions construing the phrase "business of insurance" is that state laws which regulate the insurer-insured relationship as well as the policy of insurance that governs that relationship constitute the regulation of the "business of insurance" within McCarran-Ferguson. While none of this Court's prior decisions are directly on point with this case, application of the Court's analysis leads to the conclusion that Ohio Rev. Code Ann. §3903.42 regulates the "business of insurance" pursuant to the McCarran-Ferguson Act.

In *Federal Trade Commission v. National Casualty Co.*, 357 U.S. 560 (1958), the FTC issued cease and desist orders directed toward the advertising of insurance policies. The insurers defended on the ground that insurance advertising was regulated by state law, and thus federal regulation was barred by McCarran-Ferguson. The Court agreed that McCarran-Ferguson "withdrew from the [FTC] the authority to regulate respondents' advertrising practices under their own laws." *Id.* at 563. Therefore, because the FTC sought to regulate the dealings between insurer and prospective policyholders, the "business of insurance" exemption from federal law in McCarran-Ferguson applied.

The opposite result occurred in *SEC v. Variable Annuity Life Insurance Co. of America*, 359 U.S. 65 (1959). There, the SEC contended that variable annuity contracts may not be offered for sale without compliance with federal security registration requirements. The Court rejected the defendant's McCarran-Ferguson defense, but only because the annuities did not constitute a "contract of insurance". 359 U.S. 65, 71. The Court's opinion provides the proper starting point for an analysis of the phrase "business of insurance" in this case:

> We start with a reluctance to disturb the state regulatory schemes that are in actual effect, either by displacing them or by superimposing federal requirements on transactions that are tailored to meet state requirements. When the States speak in the field of "insurance," they speak with the authority of a long tradition. For the regulation of "insurance," though within the ambit of federal power (*United States v. Underwriters Asso.*, 322 US 533) has traditionally been under the control of the States.

Id. at 68, 69.

Three more recent cases also resulted in holdings that the activity in question did not constitute the "business of insurance" under the McCarran-Ferguson Act. However, the facts in each case are very different from those in the present case and the reasoning in each compels the opposite result here.

In *SEC v. National Securities, Inc.*, 393 U.S. 453 (1969), the SEC alleged that the merger of two insurance companies was accomplished in part through deceptive communications to stockholders of the target company prohibited by federal securities laws. The Court rejected the defendants' contention that review and approval of the merger by the state insurance department precluded application of the federal securities laws by action of McCarran-Ferguson. In so holding, the Court reasoned that not all business activities of an insurance company can properly be regarded as the "business of insurance."

The Court reviewed examples of activities from its prior cases which were within the scope of the "business of insurance" phrase of McCarran-Ferguson.[17] The Court then defined "business of insurance" as follows:

> Congress was concerned with the type of state regulation that **centers around the contract of insurance**, the transaction which *Paul v. Virginia* held was not "commerce." **The relationship between insurer and insured, the type of policy which could be issued, its reliability, interpretation, and enforcement—these were the core of the "business of insurance."** Undoubtedly, other activities of insurance companies relate so closely to their status as reliable insurers that they too must be placed in the same class. But whatever the exact scope of the statutory term, it is clear where the focus was—it **was on the relationship between the insurance company and the policyholder. Statutes aimed at protecting or regulating this relationship, directly or indirectly, are laws regulating the "business of insurance."** (Emphasis added.)

393 U.S. 453, 460.

[17] "Certainly the fixing of rates is part of this business; that is what South-Eastern Underwriters was all about. The selling and advertising of policies, *FTC v. National Casualty Co.*, 357 US 560 (1958), and the licensing of companies and their agents, cf. *Robertson v. California*, 328 US 440 (1946), are also within the scope of the statute." 393 U.S. 453, 460.

In *National Securities* the State Director of Insurance had approved the merger not only under the State's laws relating to insurance securities but also in his capacity of licensor of insurers within the state. While the *National Securities* decision focused upon the state laws relating to securities, the brief portion of the Court's opinion which focused upon the state laws regarding the effect of the merger upon **policyholders**, provides an additional example of state regulation of the "business of insurance" under McCarran-Ferguson:

> The applicable statute requires the State Director of Insurance to find that the proposed merger would not "substantially reduce the security of and service to be rendered to policyholders" before he gives his approval. Ariz Rev Stat Ann §20-731B3 (Supp 1969). **This section of the statute clearly relates to the "business of insurance."** (Emphasis added).

393 U.S. 453, 462. The Court defined two separate interests, one federal, one state, that did not impair one another, but were compatible:

> The Federal Government is attempting to protect security holders from fraudulent misrepresentations; Arizona, insofar as its activities are protected by the McCarran-Ferguson Act from the normal operations of the Supremacy Clause, is attempting to protect the interests of the policyholders.

* * *

> The paramount federal interest in protecting shareholders is in this situation perfectly compatible with the paramount state interest in protecting policyholders.

Id. at 463. In the instant case, the federal and state interests are not compatible—they are diametrically opposite. Ohio has enacted laws to protect the interest of policyholders least able to bear the financial consequences of an insurance insolvency by providing a mechanism to pay policyholder claims before all other creditors or claims by governmental entities. Petitioners' contentions would allow the federal claims priority statute to benefit the federal government at the expense of individual policyholders.

Ohio Rev. Code Ann. §3903.42, directly regulates that which *National Securities* defined as the "business of insurance." The liquidation is instituted to preserve assets for all claimants and Ohio Rev. Code Ann. §3903.42 establishes a preference to first pay policyholders **in full** before general creditors and other claimants receive any funds. This enactment exists precisely to "enforce" the insurance policy, to assure its "reliability" and to "secure the interests" of the policyholders—all factors recognized in *National Securities* as constituting regulation of the "business of insurance." The statute clearly "centers around the contract of insurance," its enforcement and reliability.

Similar criteria for "business of insurance" were prescribed by this Court in *Group Life & Health Insurance Co. v. Royal Drug Co.*, 440 U.S. 205 (1979). At issue were participating pharmacy agreements entered into between an insurer and pharmacies that had no effect upon the amount of benefits under health insurance policies but did serve to reduce the insurer's

costs in providing the benefits. The Court held that the agreements could be challenged under antitrust laws and were not excepted by McCarran-Ferguson. The Court's reasoning is an extension of its holding in *National Securities*. The Court stated, that an insurance contract is the "spreading and underwriting of the policyholder's risk," 440 U.S. 205, 211; *i.e.*, an agreement to "indemnify or guarantee another against loss," *Id.*, fn. 7. Hence, the insurer's payment of a policyholder's loss is the "business of insurance," which is the very essence of Ohio Rev. Code Ann. §3903.42.

In *Royal Drug*, the pharmacy agreements did not involve underwriting risk and were not agreements "between insurer and insured." 440 U.S. 205, 216. Therefore, the agreements were not the "business of insurance." Unlike the agreement at issue in *Royal Drug*, Ohio Rev. Code Ann. §3903.42 has a direct impact on benefits available under insurance policies by directing assets toward payment of claims under policies. Accordingly, claim prioritization under Ohio Rev. Code Ann. §3903.42, regulates that which falls squarely within this Court's definition of the "business of insurance."

The Court most recently considered this issue in *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982).[18] The Court held that an insurer was subject to an

[18] Respondent believes that it is the application of the definition of the phrase "business of insurance," not the definition itself, which may differ in an anti-trust exemption case under McCarran-Ferguson. The definition must be applied narrowly in the anti-trust exemption case: "Accordingly, our precedents consistently hold that exemptions from the anti-trust laws must be construed narrowly." *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, 126. The narrow application of the definition is not required in this case. To the contrary, in order to observe the congressional purpose of McCarran-Ferguson to "broadly support existing and future state systems of regulation," a broad

(Footnote continued on following page.)

antitrust price-fixing challenge to its utilization of a peer group review committee to advise the insurer whether charges for chiropractic services were "reasonable" and "necessary" and therefore payable under health insurance policies. The separate agreement at issue was between the insurer and the committee and was not part of the insurance policies.

The Court's analysis prescribed three criteria to determine whether an insurer's activities were within the "business of insurance" exemption:

> First, whether the practice has the effect of transferring or spreading a policyholder's risk; second, whether the practice is an integral part of the policy relationship between the insurer and the insured; and third, whether the practice is limited to entities within the insurance industry. **None of these criteria** is necessarily determinative in itself. . . . (Emphasis added.)

458 U.S. 119, 129.

The Court held that the peer group arrangement met none of the criteria. Because it was not itself an insurance contract, it did not spread risk among a larger

(Footnote continued from preceding page.)
application of the definition is required here. Several commentators support the contention that the phrase "business of insurance" may have different definitions when applied to the anti-trust exemption portion of 15 U.S.C. §1012(b) then when applied to the "state regulation" portion of the same statute. D. Howard, *Uncle Sam Versus the Insurance Commissioners: A Multi-Level Approach to Defining the "Business of Insurance" Under the McCarran-Ferguson Act*, 25 Williamette Law Review 1, 79 (1989); Note, *The Definition of "Business of Insurance" Under the McCarran-Ferguson Act After Royal Drug*, 80 Colum. L. Rev. 1475, 1481 (1980). While several lower courts have acknowledged the potential for such a multi-definitional analysis (*State of Idaho ex rel. Soward v. United States*, 858 F.2d 445, 453 (9th Cir., 1988); *Lyons v. United States*, No. 4-91-10209, Slip Op. at 7 n.8 (S.D. Iowa, July 2, 1992), the court of appeals rejected such an analysis in this case finding that "its [*Pireno's*] analysis is but a distillation of the earlier cases." 939 F.2d 341, 346.

group of policyholders. It was not an integral part of the "policy relationship" because it did not modify or abrogate the insurer's contractual obligation to pay claim, but only assisted the insurer in assessing whether the services were "reasonable" and "necessary" and therefore payable under the policy. And lastly, the peer group was not an entity within the insurance industry. Ohio Rev. Code Ann. §3903.42, however, meets all three *Pireno* criteria.[19]

a. By requiring the insurer's assets to be applied first to full payment of losses under policies, the statute effectuates on a continuing basis the spreading of risk among all policyholders by distributing assets of the liquidation estate to pay the losses. Although the risk theoretically may be spread at the moment the policy is issued, in reality, the risk is not spread until insurer assets are used to pay a covered loss.[20] Moreover, "claims adjustment is part and parcel of the 'business of insurance' protected by the McCarran-Ferguson Act."[21]

[19] In *Pireno*, this Court espoused the rule that Ohio Revised Code Ann. §3903.42 need not pass all three tests to remain within the business of insurance exemption by stating "none of these criteria is necessarily determinative in itself." *Id.* at 129.

[20] While an insured is often thought to "transfer" his risk under a policy of insurance, the reality is that an insurance contract is no more than a contract of indemnity. See 1 G. Couch, *Cyclopedia of Insurance Law* §1:3 (2d ed. 1984) ("the primary requisite essential to a contract of insurance is the assumption of a risk of loss and the undertaking to indemnify the insured against such loss"). By entering into a policy of insurance the insured does not relieve himself of primary liability, rather, he merely contracts with a third party to indemnify himself and make payment in his place. Should the insurer not pay on the loss, the insured remains responsible for the loss, thereby resulting in no risk transfer. The insured will only have "transferred" or relieved himself of the risk when the claim is actually paid by the insurer on his behalf.

[21] 458 U.S. 119, 138 (Rehnquist dissent).

Therefore, because payment for and issuance of the policy spreads the risk and Ohio Rev. Code Ann. §3903.42 effectuates the insurer's obligation to pay, Ohio Rev. Code Ann. §3903.42 regulates the "business of insurance" under *Pireno's* first criterion.

Regarding the first criterion of the *Pireno* test, Petitioners argue that the Ohio statute does not have the effect of transferring and spreading a policyholder's risk. Petitioners' erroneous conclusion results from a tortured interpretation of *Pireno*. Petitioners argue that only events surrounding the actual issuance of the insurance policy could satisfy *Pireno* and that the transfer of risk is complete at the time the insurance policy is issued. Such a narrow interpretation evidences a misguided appreciation for the realities of the business of insurance. Establishing rates, adjusting policies and licensing insurance companies and their agents would not satisfy the Petitioners' narrow interpretation of the first criterion of the *Pireno* test. Yet, state statutes regulating these activities were cited as examples of regulation of the "business of insurance" within McCarran-Ferguson in *National Securities*. Contrary to the assertions of Petitioners, in *National Securities* this Court broadly interpreted the language and intent of McCarran-Ferguson to apply to statutes aimed directly or indirectly at securing the interests of policyholders and assuring the reliability of the insurance policies.

Moreover, between the governmental claimants and other policyholders, Ohio Rev. Code Ann. §3903.42 is a regulation by Ohio which determines how risk should be spread among classes of policyholders. In *Arizona Governing Committee v. Norris*, 463 U.S. 1073 (1983), Justice Powell, in dissent, reviewed the congressional history of McCarran-Ferguson and noted:

> No one doubts that the determination of how risk should be spread among classes of insureds is an integral part of the "business of insurance."

463 U.S. 1073, 1100.

b. The second criterion of *Pireno* is also satisfied. The payment of a loss is "an integral part of the policy relationship between the insurer and the insured." Indeed, it is the very essence of insurance.[22]

Ohio Rev. Code Ann. §3903.42 reinforces the contractual relationship between the insurer and insured by providing for the enforcement of that relationship when an insurer is financially impaired. The statute is designed to strengthen the relationship by prioritizing the claims of policyholders and thereby enhancing the reliability of the relationship. The liquidation statutes, and specifically Ohio Rev. Code Ann. §3903.42, provide mechanisms for adjustment of claims, defense of insureds, interpretation of policies and payment of proper claims—the heart of the "business of insurance."

c. The third *Pireno* criterion is also satisfied. An insurance company in liquidation is obviously an "entit[y] within the insurance industry." Liquidation of an insurance company is the ultimate act of insurance regulation. While a liquidation effects all parties tied

[22] Senator Ferguson's remarks clearly indicate that Congress appreciated the critical importance of payment of losses when an insurer is financially impaired at the time it enacted McCarran-Ferguson:

> The sale of insurance is not the same as the sale of an article in a store. When one buys an article in a store, he brings it home with him. In the case of insurance, he buys a **promise** to pay upon the happening of a certain event, and that event may be the burning of his home. If the company is not sound and **solvent** at the time the house burns, or **at the time the claim is made**, there is not insurance at all. That is what we have tried to avoid. (Emphasis added). 91 Cong. Rec. 1481 (1945).

economically to the insurer, the core of the liquidation process is the insurer itself and the effect of prioritization is to direct the liquidation process toward policyholders and away from non-insurance business and governmental entities.

Petitioners argue that the third criterion of the *Pireno* test is not satisfied because the liquidation process is not limited to entities within the insurance industry.[23] The most obvious flaw in Petitioners' argument is the simple fact that Ohio Rev. Code Ann. Chapter 3903 is only applicable to entities within the insurance industry.[24] The fact that "other" claimants are listed in the priority statute simply takes into account the realities of the insurance business and the fact that other tangential claims may exist. When the liquidation statute is viewed in total, the third criterion of the *Pireno* test is satisfied.

3. The Enactment History of McCarran-Ferguson Supports the Lower Court's Conclusion that 31 U.S.C. §3713 Does Not Preempt Ohio Rev. Code Ann. §3903.42.

"The question whether a certain state act is preempted by federal law is one of congressional intent. The purpose of Congress is the ultimate touchstone."[25] The Court has, on several occasions, reviewed the congressional purpose underlying the McCarran-Ferguson Act. The purpose of McCarran-Ferguson ". . . was stated quite clearly in its first section: Congress

[23] The Court has acknowledged that "the claims adjustment process itself" [*i.e.* evaluation of claims and payment of losses] occurs "wholly within the insurance industry." 458 U.S. 119, 134, fn. 8.

[24] Ohio Rev. Code Ann. §3903.03.

[25] *Pilot Life Ins. Co. v. Dedeaux*, 481 U.S. 41, 45 (1987) quoting *Allis-Chalmers Corp. v. Lueck*, 471 U.S. 202, 208 (1985); quoting *Malone v. White Motor Corp.*, 435 U.S. 497, 504 (1978), quoting *Retail Clerks v. Schermerhorn*, 375 U.S. 96, 103 (1963).

declared that 'the continued regulation and taxation by the several States of the business of insurance is in the public interest.' 59 STAT 33 (1945), 15 U.S.C. §1011.11." *SEC v. National Securities*, 393 U.S. 453, 458 (1969). Within a year following passage of McCarran-Ferguson the Court had reviewed the congressional purpose underlying the Act:

> "Obviously Congress' purpose was broadly to give support to the existing and future state systems for regulating and taxing the business of insurance . . . its purpose was evidently to throw the whole weight of its power behind the state systems. . . ."

Prudential Ins. Co. v. Benjamin, 328 U.S. 408, 429, 430 (1946).

The Report of the House Committee on the Judiciary,[26] regarding Senate Bill 340 (the McCarran-Ferguson Act), unambiguously reflects the congressional understanding that the state laws regulating and taxing insurance companies were to be supreme, unless federal legislation included language with specific reference regarding its application to the insurance business. Any other reading of the congressional intent performs a severe injustice to the all-encompassing language of the Act.

The General Statement of the Report of the House Committee on the Judiciary[27] states in part:

> The committee has therefore given immediate consideration to S. 340, together with a similar measure, H.R. 1973, so that the several States may know that the Congress desires to protect the continued regulation and taxation of the business of insurance by the several States, and thus enables

[26] H.R. Rep. No. 143, 79 Cong., 1st Sess. (1945).

[27] H.R. Rep. No. 143, 79 Cong., 1st Sess. (1945).

insurance companies to comply with State laws. What is more, **the Congress proposes by this bill to secure adequate regulation and control of the insurance business.**

* * *

It is not the intention of Congress in the enactment of this legislation to clothe the States with any power to regulate or tax the business of insurance beyond that which they had been held to possess prior to the decision of the United States Supreme Court in the Southeastern Underwriters Association case. Briefly, **your committee is of the opinion that we should provide for the continued regulation and taxation of insurance by the States,** subject always, however, to the limitations set out in the controlling decisions of the United States Supreme Court, as for instance, in *Allgeyer v. Louisiana* (165 U.S. 578), *St. Louis Cotton Compress Co. v. Arkansas* (260 U.S. 346), and *Connecticut General Insurance Co. v. Johnson* (303 U.S. 77), which hold, inter alia, that a State does not have power to tax contracts of insurance or reinsurance entered into outside its jurisdiction by individuals or corporations resident or domiciled therein covering risks within the State or to regulate such transactions in any way. (Emphasis added)

The language of the General Statement of the House Report makes clear that the intent of the Act was to "secure adequate regulation and control of **insurance business**" by delegating sweeping authority to the States, which "[n]o Act of Congress" would invalidate unless specifically excepted either in the Act or in the language of the legislation. Petitioners' efforts to narrow the focus of the Act are inconsistent with the declarations of the House Report:[28]

[28] The language employed in the analysis is of particular note. The terms "business of insurance" and "insurance business" are used interchangeably. Accordingly, the analysis of Section 2(b), which states "that no Act of Congress shall be construed to invalidate, impair, or supersede any State law which regulates or taxes the **insurance business**, unless such Act specifically so provides," can only be read to evidence a broad congressional intent.

Section 1 declares that the continued regulation and taxation by the States of the business of insurance is in the public interest.

Section 2 provides that the **insurance business,** and all persons engaged in such business, shall be subject to State laws relating to the regulation and taxation of such business; and (b) that no act of Congress shall be construed to invalidate, impair, or supersede any State law which regulates or taxes the **insurance business**, unless such act specifically so provides.

Section 3 provides that the Federal Trade Commission Act and the Robison-Patman Antidiscrimination Act shall not apply to the **insurance business**, or to acts in the conduct of such business.

Section 4 suspends the application of the Sherman Act against any act of boycott, coercion, or intimidation suspended. These provisions of the Sherman Act remain in full force and effect.

Section 5 provides that the enactment of this act shall not affect, in any manner, the present application of the National Labor Relations Act, the Fair Labor Standards Act, or the Merchant Marine Act, to the business of insurance.

Section 6 defines the term "State."

Section 7 provides for separability of provisions.

(Emphasis added).

This analysis is also reflected in the decisions of this Court that cite and interpret the legislative history and legislative intent of McCarran-Ferguson.[29] Justice

[29] When this Court held for the first time that the Federal Government had the power to regulate the business of insurance, see *United States v. Underwriters Assn.*, 322 U.S. 533 (1944) (holding the anti-trust laws applicable to the business of insurance), Congress responded by passing the McCarran-Ferguson Act. As initially proposed, the Act had a narrow focus. It would have provided only: "That nothing contained in the Act of July 2, 1890, as amended, known as the Sherman Act or the Act of October 15, 1914, as

(Footnote continued on following page.)

Harlan, in a dissenting opinion in *Fed. Trade Com. v. Travelers Health Association*, 362 U.S. 293 (1960) quoted extensively the language from *Prudential Ins. Co. v. Benjamin*, stating:

> Moreover, in taking this action Congress must have had full knowledge of the nation-wide existence of state systems of regulation and taxation; of the fact that they differ greatly in the scope and character of the regulations imposed and of the

(Footnote continued from preceding page.)

amended, known as the Clayton Act, shall be construed to apply to the business of insurance or to acts in the conduct of that business or in any wise to impair the regulation of that business by the several States." S. Rep. No. 1112, 78th Cong. 2d Sess., pt 1, p. 2 (1944) (quoting proposed Act). This narrow version, however, was not accepted.

Congress subsequently proposed and adopted a much broader bill. It recognized, as it previously had, the need to accommodate federal antitrust laws and state regulation of insurance. See H.R. Rep. No. 143, 79th Cong. 1st Sess., 3 (1945). But it also recognized that the decision in *South-Eastern Underwriters Assn.* had raised questions as to the general validity of state laws governing the business of insurance. Some insurance carriers were reluctant to comply with state regulatory authority, fearing liability for their actions. See H.R. Rep. No. 143, at 2. Congress thus enacted broad legislation "so that the several States may know that the Congress desires to protect the continued regulation . . . of the business of insurance by the several States." [citation omitted]

The McCarran-Ferguson Act, as adopted, accordingly commits the regulation of the insurance industry presumptively to the States. The introduction to the Act provides that "silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of [the] business [of insurance] by the several States." 15 U.S.C. §1011 [15 U.S.C.S. §1011]. Section 2(b) of the Act further provides: "No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance." 15 U.S.C. §1012(b) [15 U.S.C.S. §1012(b)].

Arizona Governing Committee v. Norris, 463 U.S. 1073, at 1099, N. 5 (Powell dissent) (1983).

> taxes exacted; and of the further fact that many, if not all, include features which, to some extent, have not been applied generally to other interstate business. Congress could not have been unacquainted with these facts and its purpose was evidently to throw the whole weight of its power behind the state systems, notwithstanding these variations." (Citation omitted).

Id. at 306, 307.

Finally, the legislative history is consistent with the status of state regulation prior to *United States v. South-Eastern Underwriters Assn.*, 322 U.S. 533 (1944). Prior to this Court's decision in *South-Eastern Underwriters*, "the States enjoyed a virtual exclusive domain over the insurance industry." *St. Paul Fire & Marine Ins. Co. v. Barry*, 438 U.S. 531, 539 (1978). Significantly, decisions rendered regarding the priority of claims of the United States *vis-a-vis* other claimants evidenced a view that, where a state had specifically legislated the priority of claims, the federal priority statute would not supersede the clear state legislative intent.[10] Only where no priority scheme had been established did the federal priority statute apply to create a super-priority for the claims of the United States.[11]

Petitioners have cited the Court to *United States v. Knott*, 298 U.S. 544 (1936), for the proposition that, pre-McCarran-Ferguson, the federal priority statute was applied to supersede state priority statutes. However, Petitioners misconstrue the facts in *Knott* and misread this Court's decision. Briefly, the *Knott* case dealt only with the use and disposition of special deposit funds placed with the Florida State Treasurer as a condition of

[10] *Conway v. Imperial Life Ins. Co.*, 21 So. 2d 151 (La., 1945).

[11] *Fred L. Emmons v. Union Indemnity Co.*, 175 A. 141 (N.J., 1934).

the insurer doing business in Florida.[32] Nowhere in the Florida statutes are priorities to special deposit funds established. No state priority statute was pre-empted or impaired when this Court determined that the bond claims of the federal government were entitled to priority. Therefore, the decision in *Knott* does not support Petitioners' position that prior to the decision in *South-Eastern Underwriters*, the states could not legislate claims priority in insurance insolvency proceedings. To the contrary, there is no evidence that 31 U.S.C. §3713 had ever been applied prior to the *South-Eastern Underwriters* decision to invalidate or supersede a state statute directed at regulating the distribution of assets of an insolvent insurer between classes of creditors. Therefore, in accordance with the congressional intent to commit the regulation of the insurance industry presumptively to the states, where a state has specifically set out by statute the priority rights to assets of an insolvent insurer, the federal priority statute cannot be applied to invalidate the state regulation.

[32] The specific Florida statutes in question were quoted in *Knott* as:

> Section 6302 of the Florida Laws, which required the deposit, declares: "And whenever such company ceases to do business in this State, and has settled up all claims against it, as hereinafter provided, and has been released from all the bonds upon which they have been taken as sureties said bonds [securities] shall be delivered up to the proper party on presentation of the Treasurer's receipt for said bonds."
>
> Section 6303, as amended, provides: "Whenever a final judgment has been rendered against any surety company on a fidelity, appearance, supersedeas or surety bond, the surety on said bond shall pay the same within thirty days. Upon notice of failure to pay the amount due under said bond within said time, the State Treasurer shall retain the bonds or securities deposited with him by said surety company *** to cover said judgment and costs, subject to the order of the Court trying any suit that may be brought upon said bond." [Then follows the amendment of 1933 authorizing institution of the suit.]

CONCLUSION

The judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

JAMES R. RISHEL
Counsel of Record
DAVID A. KOPECH
ZACHARY T. DONOVAN
RISHEL, MYERS & KOPECH
280 North High Street
Suite 800
Columbus, Ohio 43215
(614) 221-0717
Counsel for Respondent

Of Counsel:
LEE I. FISHER
Attorney General of Ohio

SEPTEMBER, 1992

APPENDIX

STATUTORY PROVISIONS INVOLVED

11 U.S.C. §109

§109. Who may be a debtor

(b) A person may be a debtor under chapter 7 of this title [11 USCS §§701 et seq.] only if such person is not—

* * *

(2) a domestic insurance company, ***

15 U.S.C. §1012

§1012. Regulation by State law; Federal law relating specifically to insurance; applicability of certain Federal laws after June 30, 1948.

* * *

(b) Federal regulation. No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: Provided, That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act [15 USCS §§1 et seq.], and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended [15 USCS §§41 et seq.], shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

(Mar. 9, 1945, ch 20, §2, 59 Stat. 34; July 25, 1947, ch 326, 61 Stat. 448.)

Ohio Revised Code

§3903.03 Application of sections.

The proceedings authorized by sections 3903.01 to 3903.59 of the Revised Code may be applied to any one or more of the following:

(A) All insurers who are doing, or have done, an insurance business in this state, and against whom claims arising from that business may exist now or in the future;

(B) All insurers who purport to do an insurance business in this state;

(C) All insurers who have insureds resident in this state;

(D) All other persons organized or in the process of organizing with the intent to do an insurance business in this state;

(E) All other companies, associations, societies, or entities subject to regulation by the superintendent of insurance under Title XVII [17] and XXXIX [39] of the Revised Code.

HISTORY: 139 v H 830. Eff 3-7-83.

§3903.17 Basis for liquidation order.

The superintendent of insurance may file a complaint in the court of common pleas for an order directing him to liquidate a domestic insurer or an alien insurer domiciled in this state on the basis of any one or more of the following:

* * *

(C) That the insurer is in such condition that the further transaction of business would be hazardous, financially or otherwise, to its policyholders, its creditors, or the public.

HISTORY: 139 v H 830. Eff 3-7-83.

§3903.18 Contents and effect of liquidation order; third persons charged with notice of proceedings; declaration of insolvency.

(A) An order to liquidate the business of a domestic insurer shall appoint the superintendent of insurance and his successors in office as liquidator and shall direct the liquidator forthwith to take possession of the assets of the insurer and to administer them under the general supervision of the court. The liquidator shall be vested by operation of law with the title to all of the property, contracts, and rights of action and all of the books and records of the insurer ordered liquidated, wherever located, as of the entry of the final order of liquidation.

Third persons dealing with the interest of the insurer in real property in a county are charged with notice of the pendency of an action for liquidation of the insurer when a complaint for liquidation of the insurer is filed in the court of common pleas of that county or when a certified copy of the complaint is filed with the clerk of that county under Civil Rule 3(F).

Third persons dealing with the interest of the insurer in real property in a county are charged with notice of the order for liquidation when the judgment ordering liquidation is filed under Civil Rule 58, or a certified copy of the judgment is filed under Civil Rule 3(F), with the clerk of the court of common pleas of that county.

Third persons dealing with the interest of the insurer in other types of property are charged with notice of the pendency of the action for liquidation when the complaint is filed in the court of common pleas, or when a certified copy of the complaint is filed under Civil Rule 3(F) with the clerk of the court of common pleas, of the county in which the principal business of the company is conducted or in which its principal office or place of business is located. Such persons are charged with notice of the judgment ordering liquidation when the judgment is filed under Civil Rule 58, or a certified copy of the judgment is filed under Civil Rule 3(F), with the clerk of the court of common pleas of the county in which the principal business of the company is conducted or in which its principal office or place of business is located.

§3903.21 Powers of liquidation.

(A) The liquidator may do any of the following:

* * *

(6) Collect all debts and moneys due and claims belonging to the insurer, wherever located. For this purpose, the liquidator may do any of the following:

(a) Institute timely action in other jurisdictions, in order to forestall garnishment and attachment proceedings against such debts;

(b) Do such other acts as are necessary or expedient to collect, conserve, or protect its assets or property, including the power to sell, compound, compromise, or assign debts for purposes of collection upon such terms and conditions as he considers best;

(c) Pursue any creditor's remedies available to enforce his claims.

* * *

(12) Continue to prosecute and to commence in the name of the insurer or in his own name any and all suits and other legal proceedings, in this state or elsewhere, and to abandon the prosecution of claims he considers unprofitable to pursue further. If the insurer is dissolved under section 3903.20 of the Revised Code, he shall have the power to apply to any court in this state or elsewhere for leave to substitute himself for the insurer as plaintiff.

§3903.32 Recovery from reinsurers.

The amount recoverable by the liquidator from reinsurers shall not be reduced as a result of delinquency proceedings, regardless of any provision in the reinsurance contract or other agreement. Payment made directly to an insured or other creditor does not diminsh the reinsurer's obligation to the insurer's estate except when the reinsurance contract provides for direct coverage of a named insured and the payment is made in discharge of that obligation.

HISTORY: 139 v H 530. Eff. 3-7-83.

§3903.33 Payment of unpaid earned premiums.

(A) An agent, broker, premium finance company, or any other person, other than the insured, responsible for the payment of a premium is obligated to pay any unpaid earned premium due the insurer at the time of the declaration of insolvency, as shown on the records of the insurer. The liquidator may recover from such person any part of an unearned commission of such person.

(B) An insured shall be obligated to pay any unpaid earned premium due the insurer at the time of the declaration of insolvency, as shown on the records of the insurer.

HISTORY: 139 v H 830. Eff. 3-7-83.

§3903.43 Review, investigation and negotiation of claims; report on claims.

(A) The liquidator shall review all claims duly filed in the liquidation and shall make such further investigation as he considers necessary. He may compound, compromise, or in any other manner negotiate the amount for which claims will be recommended to the court except where the liquidator is required by law to accept claims as settled by any person or organization, including any guaranty association or foreign guaranty association. Unresolved disputes shall be determined under section 3903.39 of the Revised Code. As soon as practicable, he shall present to the court a report of the claims against the insurer with his recommendations. The report shall include the name and address of each claimant and the amount of the claim finally recommended, if any. If the insurer has issued annuities or life insurance policies, the liquidator shall report the persons to whom, according to the records of the insurer, amounts are owed as cash surrender values or other investment value and the amounts owed.

(B) The court may approve, disapprove, or modify the report on claims by the liquidator. Such reports as are not modified by the court within a period of sixty days following submission by the liquidator shall be treated by the liquidator as allowed claims, subject thereafter to later modification or to rulings made by the court pursuant to section 3903.39 of the Revised Code. No claim under a policy of insurance shall be allowed for an amount in excess of the applicable policy limits.

HISTORY: 139 v H 830. Eff 3-7-83.

§3903.44 Manner of payment; distribution in kind.

Under the direction of the court, the liquidator shall pay distributions in a manner that will assure the proper recognition of priorities and a reasonable balance between the expeditious completion of the liquidation and the protection of unliquidated and undetermined claims, including third party claims. Distribution of assets in kind may be made at valuations set by agreement between the liquidator and the creditor and approved by the court.

HISTORY: 139 v H 830. Eff 3-7-83.

LYONS v. UNITED STATES, Civil No. 4-91-10209
S.D. Iowa July 2, 1992 (unreported)

CIVIL NO. 4-91-10209

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF IOWA
CENTRAL DIVISION

DAVID J. LYONS, Commissioner of Insurance
for the State of Iowa, as Liquidator
of Carriers Insurance Company,
Plaintiff,

vs.

UNITED STATES OF AMERICA,
Defendant.

ORDER

Before the court for ruling is plaintiff's motion for summary judgment that December 5, 1991. The government resisted on March 19, 1992. Plaintiff filed his reply on April 3, 1992.

BACKGROUND

Plaintiff, the Iowa Insurance Commissioner, instituted the present lawsuit as liquidator for the insolvent Carriers Insurance Co., (Carriers) contesting an IRS determination that in 1980, Carriers illegally

changed accounting methods. The IRS determined this illegal change resulted in an underreporting of income, and as a consequence assessed Carriers with additional tax liability. In 1982, Carriers experienced an operating loss entitling it to a business-loss carry back to 1980. The 1982 loss carry back was not sufficient to cover the entire amount of tax and interest due, however, and the liability not extinguished by the carry back continued to accrue interest until March, 1991 when the total amount due was paid. Plaintiff then instituted this suit seeking a refund.

The parties have settled one of the two issues presented for summary judgment as the United States has agreed to refund the interest which accrued after Carriers was declared insolvent. The remaining issue focuses on which priority statute governs the distribution of assets of an insolvent insurance company. More specifically, should Iowa law or federal law determine creditor priority.

APPLICABLE LAW AND DISCUSSION

Preliminarily, the court notes that this matter is before it on plaintiff's motion for summary judgment, and summary judgment is "clearly appropriate where the court is faced with a motion . . . for summary judgment, wherein all parties admit to undisputed facts and are merely seeking a declaration of the law." *Gordon v. United States Dept. of Treasury,* 668 F. Supp. 483, 487 (D.Md. 1987). The parties in this case have stipulated to the facts and are seeking a declaration from this court of which law will decide insolvent insurer creditor priority. The issue is ripe for summary judgment.

A. JURISDICTIONAL ISSUE

The United States initially urges that this court lacks jurisdiction to consider the remaining summary judgment issue because plaintiff has sought relief under 28 U.S.C. §2201, the Declaratory Judgment Act. The Act provides that a court may declare rights in any case of actual controversy within its jurisdiction except with respect to federal taxes other than actions brought under §7428.[1]

The government's jurisdictional argument is flawed. The declaratory relief sought in count II of plaintiff's amended complaint is a separate and distinct issue from the request for a tax refund in count I. In count II, the plaintiff seeks a declaration regarding which law governs creditor priority for insolvent insurance companies. The exception in §2201 regarding federal taxes is inapplicable in this instance because the declaratory relief sought does not relate to federal taxes even though resolution of the issue in favor of plaintiff may, as a practical matter, render the count I tax refund claim moot.

Rather, count II presents an actual controversy within this court's jurisdiction involving the interrelationship of the McCarran-Ferguson Act, the Federal Insolvency Statute and the Iowa priority statute[2]. As acknowledged by the government's counsel during oral argument, plaintiff is entitled to a federal forum to resolve this issue. The controversy falls within this court's subject matter jurisdiction, and the court

[1] 26 U.S.C. §7428 provides for declaratory judgments relating to status and classification of organizations under sections 501(c)(3), 509(a) and 4942(j)(3).

[2] Iowa Insurers Supervision Rehabilitation and Liquidation Act, Iowa Code §507C.42.

may properly consider declaratory relief regarding it. The real issue is whether a determination of the statutory interrelationship issue should be deferred pending resolution of the tax controversy. The court finds that there should be no deferral.

B. McCARRAN-FERGUSON ACT

The regulation of the "business of insurance" has been delegated to the individual states by the McCarran-Ferguson Act:

> The business of insurance, and every person engaged therein, shall be subject to the laws of the several states which relate to the regulation or taxation of such business.
>
> No act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any state for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such act specifically relates to the business of insurance: Provided, that [the Sherman Act, Clayton Act and Federal Trade Commission Act] shall be applicable to the business of insurance to the extent that such business is not regulated by state law.

15 U.S.C. §1012(a) & (b).

Plaintiff claims that part of regulating the "business of insurance" is determining the priority of payment among creditors of insolvent insurance companies and that the Iowa insurance priority statute is controlling. In addressing priority, the statute specifies five classes of creditors with payment for federal taxes ranking last. In contrast, the United States maintains that creditor priority should be determined by an application of the Federal Insolvency Statute, 31 U.S.C. §3713, which places tax collection at the top of the priority list. The

government contends that the McCarran-Ferguson Act does not apply because this case does not involve the regulation of the "business of insurance," a phrase that has been narrowly defined by the Supreme Court.

The Supreme Court in two antitrust cases set out a test to determine if an activity regulated by the state is to be considered the "business of insurance" within the meaning of the McCarran-Ferguson Act. *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205 (1979); *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982). The court found three criteria relevant in determining whether a particular practice is part of the "business of insurance" exempted from the anti-trust laws by ¶2(b) of the McCarran-Ferguson Act: (1) whether the practice has the effect of transferring or spreading a policyholder's risk; (2) whether the practice is an integral part of the policy relationship between the insurer and the insured; and (3) whether the practice is limited to entities within the insurance industry. *Pireno*, 458 U.S. at 126-129.

Three circuit court decisions have addressed the question of whether state or federal law should determine the priority of creditors of insolvent insurance companies. Two cases decided in 1988 by the Ninth and Fourth Circuits favor the government's position and hold that the Federal Insolvency Statute preempts the states' insurance priority statutes. *Gordon v. United States Department of Treasury*, 846 F.2d 272 (4th Cir. 1988); *State of Idaho ex rel. Soward v. United States*, 858 F.2d 445 (9th Cir. 1988). A 1991 Sixth Circuit case held that the state insurance statute properly regulated the priority of creditors of an insurance company and was within the definition of the business of insurance according to the McCarran-Ferguson Act. *Fabe v. United States Department of Treasury*, 939 F.2d 341 (6th Cir.

1991). The court in *Fabe* applied the three-part test set forth in *Pireno* to determine the scope of the phrase, "the business of insurance." The Eighth Circuit has not yet considered this issue.

There are also several federal courts that have abstained from exercising federal jurisdiction in cases involving state insurance liquidation priority schemes on McCarran-Ferguson grounds. *See e.g., Grimes v. Crown Life Ins. Co.*, 857 F.2d 699 (10th Cir. 1988) (court abstains declaring receivership regulations are laws concerning the "business of insurance"); *Levy v. Lewis*, 635 F.2d 960 (2d Cir. 1980) (court abstains in case involving conflict between state insurance liquidation statute and ERISA); *Washburn v. Corcoran*, 643 F.Supp. 554 (S.D.N.Y. 1986) (court abstains in conflict between Federal Arbitration Act and New York law regulating the liquidation of domestic insurance companies). The *Fabe* court found these abstention cases persuasive even though they did not apply the *Pireno* three-part analysis to determine if the act of liquidation was to be considered the "business of insurance" according to McCarran-Ferguson.

This is a difficult question. There are strong public policy arguments on both sides. Usually federal law is supreme, but Congress has carved out a niche for states to regulate insurance companies through the McCarran-Ferguson Act. In addition, Congress has specifically exempted insurance companies from liquidation under the federal bankruptcy code, 11 U.S.C. §109, and have entrusted the liquidation of insolvent insurance companies to the states.

The focus of the McCarran-Ferguson Act is on protecting policyholders. In *National Securities & Exchange Commission v. National Securities*, 393 U.S. 453 (1969), the Supreme Court stated,

> whatever the exact scope of the statutory term, (the "business of insurance"), it is clear where the focus (of the McCarran-Ferguson Act) was—it was on the relationship between the insurance company and the policyholder. Statutes aimed at protecting this relationship, directly or indirectly, are laws regulating the "business of insurance."

National Securities, 393 U.S. at 460. The Sixth Circuit in *Fabe*, observed that "it is clear from the language and operation of [Ohio's Insolvent Insurer's statute] that its focus is the protection of insureds by diverting the scarce resources of the liquidated entity away from any non-insured creditors, toward policyholders." Iowa's insolvent insurer's statute is similarly focused. After carefully examining the cases previously cited, the court concurs with the reasoning in Judge Martin's opinion in *Fabe* and concludes that a state's insolvent insurer's statute regulates activities falling within the definition of the "business of insurance" as required in the McCarran-Ferguson Act.[3]

[3] In discussing the meaning of the "business of insurance," the *Fabe* court held that the three-factor test that determines what constitutes the "business of insurance" as set forth in *Pireno* and *Royal Drug* applied to non-antitrust situations. *Pireno* and *Royal Drug* involved antitrust claims.

An alternative approach is suggested by Davis Howard's article, *Uncle Sam Versus the Insurance commissioners: A Multi-Level Approach to Defining the "Business of Insurance" under the McCarran-Ferguson Act*, 25 Williamette L. Rev. 1 (1989). This court finds the multi-definitional analysis advocated in Howard's article to be intriguing and perhaps preferable to the tripartite *Pireno* analysis on the issue of defining the "business of insurance" in non-antitrust cases. The author suggests applying the test set forth in *National Securities* to determine what constitutes the business of insurance, and proposes a broadening of the definition in superpriority cases. The court found no case adopting the author's position.

CONCLUSION AND ORDER FOR JUDGMENT

IT IS ORDERED that summary judgment shall be entered on count II in favor of the plaintiff, declaring that the Iowa Insurers Supervision Rehabilitation and Liquidation Act, Iowa Code §507C.42 is a state law regulating the business of insurance within the meaning of the McCarran-Ferguson Act, 15 U.S.C. §1012.

Dated this 2nd day of July, 1992.

/s/ Ronald E. Longstaff
Ronald E. Longstaff, *Judge*
United States District Court

CIVIL NO. 4-91-10209

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF IOWA
CENTRAL DIVISION

DAVID J. LYONS, Commissioner of Insurance
for the State of Iowa, as Liquidator
of Carriers Insurance Company,
Plaintiff,

vs.

UNITED STATES OF AMERICA,
Defendant.

JUDGMENT IN A CIVIL CASE
AS TO COUNT II ONLY

[x] Decision by Court. This action came to consideration before the Court. The issues have been considered and a decision has been rendered.

IT IS ORDERED AND ADJUDGED that summary judgment shall be entered on count II in favor of the plaintiff, declaring that the IA Insurers Supervision Rehabilitation and Liquid Act, IA Code 507C.42 is a state law regulating the business of insurance within the meaning of the McCarran-Ferguson Act, 15 USC 1012.

July 2, 1992
Date

JAMES R. ROSENBAUM
Clerk

/s/ Illegible
(By) Deputy Clerk

(17)

No. 91-1513

In the Supreme Court of the United States

OCTOBER TERM, 1992

UNITED STATES DEPARTMENT OF THE TREASURY AND MITCHELL A. LEVINE, ASSISTANT COMMISSIONER, PETITIONERS

v.

GEORGE FABE, SUPERINTENDENT OF INSURANCE, STATE OF OHIO

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

REPLY BRIEF FOR THE PETITIONERS

KENNETH W. STARR
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 514-2217

TABLE OF AUTHORITIES

Cases: Page

Constitution and statutes:

In the Supreme Court of the United States

OCTOBER TERM, 1992

No. 91-1513

UNITED STATES DEPARTMENT OF THE TREASURY AND MITCHELL A. LEVINE, ASSISTANT COMMISSIONER, PETITIONERS

v.

GEORGE FABE, SUPERINTENDENT OF INSURANCE, STATE OF OHIO

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

REPLY BRIEF FOR THE PETITIONERS

---

1. Respondent contends (Resp. Br. 8-10) that the plain language of the McCarran-Ferguson Act answers the question presented in this case. We agree. In our opening brief, we explain (Pet. Br. 14-16) that the Ohio priority statute does not regulate "the business of insurance" within the ordinary meaning of that phrase. The statute applies only when an insurer has been declared insolvent, its business has been wound up, and its assets are distributed among its creditors. The Ohio statute does not regulate the terms of insurance policies, the selling or advertising of insurance, or any other business activity of insurers. Thus, the Ohio statute plainly does not regu-

late the business of insurers, let alone "the business of insurance." [1]

Contrary to petitioner's contention (Resp. Br. 2), the Ohio legislature has not stated that payment of policyholder claims is the "paramount goal" of the liquidation process. Instead, the Ohio Code states that "the purpose of [the insurance insolvency laws] is the protection of the interests of insureds, claimants, creditors, and the public generally, with minimum interference with the normal prerogatives of the owners and managers of insurers, through * * * [e]quitable apportionment of any unavoidable loss." Ohio Rev. Code Ann. § 3903.02(D) (Anderson 1989). In accordance with that broader purpose, the Ohio priority statute ranks *all* types of claims against insolvent insurers. Concern for policyholders scarcely justifies subordinating claims of the United States to various *non-policyholder* claims, including claims of general unsecured creditors.

Moreover, the Ohio priority statute ranks two classes of claims—administrative claims and wage claims—*ahead* of policyholder claims. Thus, respondent's statement (Resp. Br. 17) that the Ohio priority statute "require[s] the insurer's assets to be applied first to full payment of losses under policies" is wrong. There is no guarantee that after the first two classes of claims have been paid, the remaining assets will be sufficient to pay policyholders' claims. Indeed, one commentator has noted that policyholder claims "are relegated to a relatively low status" and that

[1] The Ohio Code expressly distinguishes between "[r]egulation of the insurance business" and "[e]quitable apportionment of any unavoidable loss." Ohio Rev. Code Ann. § 3903.02(D)(4) and (6) (Anderson 1989 & Supp. 1991).

"[a]dministration expenses, and wage payments will often exhaust the insurer's assets." K. Doughty, *Policyholders' Rights in Insolvency Proceedings*, in *Law and Practice of Insurance Company Insolvency Revisited*, 1989 A.B.A. Tort and Ins. Practice Sec. 953, 975-976.

The Ohio priority statute contrasts sharply with other provisions of Ohio's insurance law that are intended to ensure that valid policyholder claims are paid. Ohio, like other States, has established an insurance guaranty fund to pay policyholder claims in the event the insurer becomes insolvent. See Ohio Rev. Code Ann. §§ 3955.01 *et seq.*, 3956.01 *et seq.* (Anderson 1989 & Supp. 1991). See generally National Conf. of Ins. Guaranty Funds Br. 1-3. The purpose of the guaranty fund is to pay covered policyholder claims without undue delay. *Id.* § 3955.03. Policyholder claims against insolvent insurers are paid out of the fund, and the fund is subrogated to the policyholder's claim against the insurer's estate. *Id.* § 3955.12(A). Consequently, the priority statute generally does not determine whether policyholder claims will be paid, but simply whether the guaranty fund or the federal government will bear the cost of unpaid claims of United States.[2]

Respondent errs in contending (Resp. Br. 2) that the Ohio priority statute regulates the business of insurance merely because it "is part and parcel of

[2] Ohio's guaranty funds cover most types of policyholder claims up to $300,000 without any deductible, *id.* Ohio Rev. Code Ann. § 3955.01 (Anderson 1989 & Supp. 1991) (or up to $100,000 for health insurance benefits, *id.* § 3956.04), including claims for refunds of unearned premiums. *Id.* § 3955.01.

a large, complex and specialized administrative system." See also Melahn Br. 7-9. This Court has recognized that "[m]any aspects of insurance companies are regulated by state law, but are not the 'business of insurance,'" including "the composition of their boards of directors, when their books and records could be inspected, how they could invest their funds, [and] when they could liquidate or merge." *Group Life & Health Ins. Co.* v. *Royal Drug Co.*, 440 U.S. 205, 230 n.38 (1979). Similarly, respondent contends (Resp. Br. 9) that "the liquidator of an insolvent insurance company performs all functions necessary to conduct the business of insurance," and therefore engages in "the business of insurance" for purposes of McCarran-Ferguson. That responds to an argument we have not made. We do not contend that *no* statute regulating insurance company liquidators may be a regulation of "the business of insurance," but merely that the Ohio priority statute at issue here is not such a regulation.[3]

2. Some of respondent's amici contend that this Court's three-part test for determining whether a practice is part of "the business of insurance," see *Union Labor Life Ins. Co.* v. *Pireno*, 458 U.S. 119, 129 (1982), applies only in the antitrust context.

[3] Respondent and some of his amici rely on cases in which federal courts have abstained from deciding issues connected with insurer insolvencies on the basis of *Burford* v. *Sun Oil Co.*, 319 U.S. 315 (1943). See Resp. Br. 5 n.3; Gordon Br. 20-22; Melahn Br. 11-13. Although the existence of a comprehensive state system of insurance regulation may support *Burford* abstention in appropriate cases, it does not follow that every state law that regulates insurance companies is a law regulating "the business of insurance" for purposes of McCarran-Ferguson.

The amici contend that a different—and much less rigorous—test applies elsewhere. See Mich. Br. 22-47; Va. Bureau of Ins. Br. 18-21; Curiale Br. 11-15; Selcke Br. 26-27; Council of State Gov'ts Br. 22-27; NAIC Br. 11-13. Respondent himself rejects this radical argument, see Resp. Br. 15 n.18—and for good reason.

Section 2(b) of the McCarran-Ferguson Act provides, in part:

> No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating *the business of insurance*, unless such Act specifically relates to *the business of insurance: Provided*, That * * * [the federal antitrust statutes] shall be applicable to *the business of insurance* to the extent that such business is not regulated by State Law."

15 U.S.C. 1012(b) (emphasis added). Congress thus used the identical phrase "the business of insurance" in consecutive sentences of a single subsection of McCarran-Ferguson. The "normal rule of statutory construction" is that "identical words used in different parts of the same act are intended to have the same meaning." *Sullivan* v. *Stroop*, 496 U.S. 478, 484 (1990), quoting *Sorenson* v. *Secretary of the Treasury*, 475 U.S. 851, 860 (1986), quoting *Helvering* v. *Stockholms Enskilda Bank*, 293 U.S. 84, 87 (1934), quoting *Atlantic Cleaners & Dyers, Inc.* v. *United States*, 286 U.S. 427, 433 (1932). There is no reason to depart from that rule in this case. Indeed, the "normal rule" applies with added force where the

same words are used more than once in a single subsection of a statute.[4]

In support of their contention that Congress intended that the phrase "business of insurance" have one meaning in antitrust cases and another meaning in other cases, the amici observe that both *Pireno* and *Royal Drug* involved alleged violations of the antitrust laws. Respondents ignore the *Pireno* and *Royal Drug* pedigree. The test the Court applied in those cases incorporated and refined the Court's analysis in earlier *non-antitrust* cases. For example, the requirement of risk transfer is derived directly from *SEC* v. *Variable Annuity Life Ins. Co.*, 359 U.S. 65 (1959). See *Royal Drug*, 440 U.S. at 212. And the requirement that "the practice is an integral part of the policy relationship between the insurer and the insured," *Pireno*, 458 U.S. at 129, is a refinement of the Court's analysis in *SEC* v. *National Securities Inc.*, 393 U.S. 453, 460 (1969). The suggestion that the *Pireno* test applies only in antitrust cases is also refuted by this Court's decisions employing the *Pireno* test to construe similar language in ERISA. See *Pilot Life Ins. Co.* v. *Dedeaux*, 481 U.S.

---

[4] Amici derive their proposal largely from Howard, *Uncle Sam Versus the Insurance Commissioners: A Multi-Level Approach to Defining the "Business of Inurance" Under the McCarran-Ferguson Act*, 25 Willamette L. Rev. 1 (1989). The author of that article frankly recognizes that "a dual definition would contravene the principle * * * that the same words used in close proximity within the same statute should have the same meaning," and would imply "that the Congress that passed the McCarran Act was extraordinarily inept in its draftsmanship abilities." *Id.* at 39 n.114.

41, 48-49 (1987); *Metropolitan Life Ins. Co.* v. *Massachusetts*, 471 U.S. 724, 743 (1985).[5]

The amici correctly note that Section 2(b) has dual purposes:

> [T]he *primary* purpose of the McCarran-Ferguson Act was to preserve state regulation of the activities of insurance companies, as it existed before the *South-Eastern Underwriters* case. * * * The McCarran-Ferguson Act operates to assure that the States are free to regulate insurance companies without fear of Commerce Clause attack. * * * [T]he quite different *secondary* purpose of the McCarran-Ferguson Act [is] to give insurance companies only a limited exemption from the antitrust laws.

Royal Drug, 440 U.S. at 218 n.18. Congress created a limited antitrust exemption for insurer activities that are (1) part of "the business of insurance," (2) regulated by state law, and (3) not acts of boycott, coercion or intimidation, 15 U.S.C. 1013(b). *Pireno*'s relatively narrow construction of "the business of insurance" advances this congressional purpose and is consistent with the rule that "exemptions from the antitrust laws must be construed narrowly." *Pireno*, 458 U.S. at 126; see also *Royal Drug*, 440 U.S. at 231.

---

[5] Amici suggest (Mich. Br. 40-41) that *Pireno* and *Royal Drug* are inapposite because those cases examined particular practices of insurers, while this case concerns a state statute. But in determining whether a state statute regulates "the business of insurance," it is necessary to consider the practices that are regulated by the statute. In this case, *no* business practice of insurers is at issue, because the insolvent insurer's business affairs have been wound up.

Contrary to amici's contention, *Pireno's* construction of "the business of insurance" preserves the States' traditional authority to regulate the activities of insurers. In the decade since the Court's decision in *Pireno*, we are aware of no decision invalidating a state law regulating insurance companies on Commerce Clause grounds. The *Pireno* test thus is fully adequate to "assure that the States are free to regulate insurance companies without fear of Commerce Clause attack." *Royal Drug*, 440 U.S. at 218 n.18.[6]

3. In contrast to his amici, respondent acknowledges (Resp. Br. 15 n.18) that the *Pireno* test applies in this case. Respondent's contention (*id.* at 17) that the Ohio priority statute "meets all three *Pireno* criteria" is unpersuasive.

a. In our opening brief, we explain (Pet. Br. 16-19) that the first *Pireno* factor—whether the practice at issue "has the effect of transferring or spreading a policyholder's risk," 458 U.S. at 129—requires, at a minimum, that the insurer undertake some risk. The Ohio priority statute does not involve a transfer of risk from the policyholder to the insurer. The statute simply determines the order in which creditors of an insurance company will be paid in the

[6] In place of the *Pireno* test, the amici urge the Court to apply a less demanding test that they extract from this Court's decision in *SEC* v. *National Securities, supra.* As we explain below, see pp. 10-11, *infra*, the Ohio priority statute does not regulate "the business of insurance" as that phrase was construed in *National Securities*. The Ohio statute has nothing to do with the validity of a policyholder's contractual claim, and does not "so closely affect the 'reliability, interpretation, and enforcement' of the insurance contract * * * as to fall within the exempted area." *Royal Drug*, 440 U.S. at 216. See *Idaho ex rel. Soward* v. *United States*, 858 F.2d 445, 452-453 (9th Cir. 1988).

event the insurer becomes insolvent. Nor does the Ohio statute involve risk spreading—*i.e.*, the assumption of numerous, relatively small, independent risks that occur randomly over time. Each of the insurer's policyholders (as well as the insurer's other creditors) faces the identical risk that the insurer will become insolvent. Thus, the creditors do not face numerous, independent risks of insurer insolvency.

Respondent contends (Resp. Br. 17) that "the risk is not spread until insurer assets are used to pay a covered loss." See also *id.* at 18 (denying that "the transfer of risk is complete at the time the insurance policy is issued"). This Court has squarely rejected petitioner's contention. In *Pireno*, the insurance company argued that "the transfer of risk from an insured to his insurer actually takes place not when the contract between those parties is completed, but rather only when the insured's claim is settled." 458 U.S. at 131. The Court concluded that "[t]he transfer of risk from insured to insurer is effected by means of the contract between the parties—the insurance policy—and that transfer is complete at the time that the contract is entered." 458 U.S. at 130. That principle applies in this case and refutes respondent's argument that the Ohio priority statute transfers risk.[7]

[7] Respondent's contention (Resp. Br. 17) that "claims adjustment is part and parcel of the 'business of insurance' " is beside the point. The Ohio priority statute does not regulate the process of determining the validity and amount of a policyholder's claim. Instead, the statute simply determines the order in which valid claims—including policyholder claims—will be paid out of the estate of an insolvent insurer. Cf. *Pireno*, 458 U.S. at 138 n.3 (Rehnquist, J., dissenting) (noting difference between "method of paying a claim" and "more fundamental process of assessing the validity of a claim and determining the amount to be paid").

b. Respondent contends (Resp. Br. 19) that the second *Pireno* criterion—whether the practice is "an integral part of the policy relationship between the insurer and the insured," 458 U.S. at 129—is satisfied because the Ohio priority statute increases the probability that a policyholder's claims will be paid. But the Ohio priority statute, rather than addressing the relationship between policyholder and insurer, addresses the relationship among the various classes of creditors of the defunct insurer. As we explain in our opening brief (Pet. Br. 19-20), the Ohio priority statute has nothing whatever to do with the validity or amount of the policyholder's contractual claim against the insurer. Instead, the statute comes into play only if (1) it is determined, under other provisions of law, that the policyholder has a valid claim against the insurer, and (2) the insurer becomes insolvent and is liquidated. At that point, the insurer's business has been wound up, and there is no continuing relationship between the policyholder and the insurer.

Nor does the Ohio priority statute "so closely affect the 'reliability, interpretation, and enforcement' of the insurance contract * * * as to fall within the exempted area." *Royal Drug*, 440 U.S. at 216. As we have explained, see p. 3, *supra*, Ohio has established an insurance guaranty fund to pay valid policyholder claims against insolvent insurance companies. See Ohio Rev. Code Ann. §§ 3955.01 *et seq.* (Anderson 1989 & Supp. 1991), 3956.01 *et seq.* (Anderson Supp. 1991). Because the priority statute is unlikely to determine *whether* a policyholder's claim is paid, it is not so closely connected to the contractual relationship between the insurer and the insured as to qualify for the McCarran-Ferguson exemption.

Pireno, 458 U.S. at 132. It is true that according priority to federal claims may increase demands on state insurance guaranty funds, and that in turn may increase the insurers' cost of doing business. But as the Court recognized in *Royal Drug*, virtually all state regulation of insurance companies has some effect on the insurance companies' cost of doing business. An argument that such an effect is enough to bring the statute within the McCarran-Ferguson exemption thus "proves too much." 440 U.S. at 216.

c. Respondent argues (Resp. Br. 19-20) that the Ohio priority statute is "limited to entities within the insurance industry," 458 U.S. at 129—the third *Pireno* factor—because it applies to insurance companies. The Ohio statute plainly is not *limited* to entities within the insurance industry. The statute regulates the priority of *all* types of creditors' claims against insolvent insurers, including many creditors that are not part of the insurance industry. Although respondent characterizes non-policyholder claims as "tangential," Resp. Br. 20, the Ohio priority statute itself ranks two classes of non-policyholder claims ahead of policyholder claims.

Respondent's proposed redefinition of the third *Pireno* factor to cover any group of entities that *includes* insurance companies would expand the "business of insurance" beyond any manageable limits. Respondent's approach is also inconsistent with the purpose of this factor, which is to reflect "the primary concern of both representatives of the insurance industry and the Congress * * * that cooperative rate-making efforts be exempt from the antitrust laws." *Royal Drug*, 440 U.S. at 221.

4. Respondent contends (Resp. Br. 20-26) that the enactment history of McCarran-Ferguson sup-

ports the view that the Ohio priority statute regulates the "business of insurance." Respondent is incorrect. Congress enacted McCarran-Ferguson in the wake of *United States* v. *South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944), which held that "the business of insurance is interstate commerce." *Royal Drug*, 440 U.S. at 217. The Act was intended to assure that state regulation and taxation of the business of insurance would not be found to violate the Commerce Clause. See *Royal Drug*, 440 U.S. at 218 n.16 (quoting S. Rep. No. 20, 79th Cong., 1st Sess. 1-2 (1945); H.R. Rep. No. 143, 79th Cong., 1st Sess. 2 (1945)). Because the Act was largely "an attempt to turn back the clock" to the days prior to the Court's decision in *South-Eastern Underwriters*, *National Securities*, 393 U.S. at 459, Congress did not intend "to clothe the States with any power to regulate or tax the business of insurance beyond that which they had been held to possess prior to" that decision, H.R. Rep. No. 143, *supra*, at 3.[8]

Prior to the decision in *South-Eastern Underwriters*, it was clear that States had no power to override the federal priority statute in insurance insolvency proceedings. That is so because the federal priority statute does not rest on Congress's power under the Commerce Clause, but instead on its power "[t]o establish * * * uniform Laws on the subject of Bankruptcies throughout the United States." U.S. Const. Art. I, § 8, Cl. 4. It is therefore not surprising that

[8] McCarran-Ferguson did not "turn back the clock" in all respects because it did not grant the States all the regulatory authority that they possessed prior to *South-Eastern Underwriters*. But Congress did not grant the States any *additional* authority beyond the authority that they had traditionally possessed. See Pet. Br. 23-25 & n.10.

this Court held, prior to *South-Eastern Underwriters*, that the federal priority statute applied in state proceedings to liquidate an insolvent insurance company and preempted an inconsistent state statute. *United States* v. *Knott*, 298 U.S. 544 (1936).

Respondent's efforts to distinguish *Knott* are unconvincing. Respondent asserts (Resp. Br. 26) that "[n]owhere in the Florida statutes are priorities to special deposit funds established," and that consequently "[n]o state priority statute was pre-empted or impaired when this Court determined that the bond claims of the federal government were entitled to priority." Respondent is simply incorrect. The Florida statute at issue in *Knott* plainly provided for payment of in-state creditors ahead of all other creditors. See 298 U.S. at 546. Although the Ohio priority statute contains a more elaborate classification of claims, the statute at issue in *Knott* unquestionably was a form of priority statute—it ranked claims of Florida creditors ahead of other claims.

Respondent also observes (Resp. Br. 26) that *Knott* involved the disposition of assets that an out-of-state insurer placed on deposit with Florida as a condition of doing business in that State. But nothing in the Court's opinion suggests that it would have reached a different result if some other type of insurance company asset had been at issue. If anything, the nature of the assets at issue in *Knott* suggests that the State had a heightened interest in controlling their disposition.[9]

[9] State courts, both before and after McCarran-Ferguson, reached the same result as this Court in *Knott*. See Pet. Br. 24 n.11 (collecting authorities). Respondent asserts (Resp. Br. 25) that, prior to *South-Eastern Underwriters*, courts

5. Finally, respondent and his amici contend, as a matter of policy, that claims of the United States should not be entitled to first priority in insurance insolvency proceedings. The short answer is that these arguments should be addressed to Congress, not the courts. In any event, respondent's policy arguments are overstated.

The purpose of the federal priority statute is to "secure an adequate revenue to sustain the public burdens, and discharge the public debts." *United States* v. *State Bank*, 31 U.S. (6 Pet.) 29, 35 (1832). According first priority to federal claims thus advances the strong public interest in increasing the federal revenue and reducing the deficit.

Respondents' amici assert that the federal interest in deficit reduction is more than offset by the States' interest in protecting policyholders against loss in the event of insurer insolvency. See NAIC Br. 14 ("States would be rendered incapable of providing the special protection needed by policyholders."). But as we have explained, see p. 3, *supra*, policyholder claims against insolvent insurance companies generally are paid out of insurance guaranty funds, which are then subrogated to the policyholders' claims

---

held that "where a state had specifically legislated the priority of claims, the federal priority statute would not supersede the clear state legislative intent." The single authority that respondent cites, *Conway* v. *Imperial Life Ins. Co.*, 21 So. 2d 151 (La. 1945), does not support that proposition. In *Conway*, the court held that the federal priority statute did not apply because the assets at issue were held "in trust * * * as security for the policy holders," and therefore were not part of the insurance company's estate. *Id.* at 154. See *Knott*, 298 U.S. at 548 (federal priority statute inapplicable if state statute divests insurance company of title to assets).

against the insurer's estate. According first priority to federal claims may increase the demands on guaranty funds, and that in turn may increase the insurers' cost of doing business. But the alternative is to leave valid claims of the United States unsatisfied —a loss ultimately borne by the citizens of all the States.

Respondents' amici also suggest (Selcke Br. 8) that applying the federal priority statute will "wreak havoc" on state regulation of insurance companies. That concern is greatly overstated. Resolution of the narrow question presented in this case—whether claims of the United States are entitled to first priority in insurance insolvency proceedings—will not call into question the States' broad authority to tax and regulate the business of insurance.[10]

---

[10] Amicus National Conference of Insurance Legislators contends (Br. 5-20) that the federal Bankruptcy Code, McCarran-Ferguson, and the federal priority statute, when read together, demonstrate that Congress did not intend the federal priority statute to apply in insurance insolvency proceedings. That contention is wholly unconvincing. The federal Bankruptcy Code does not apply to insurance companies. See 11 U.S.C. 109(b)(2), 109(d). Consequently, the provisions of the Bankruptcy Code establishing the priority of claims of the United States do not affect "the priority of claims of the United States in non-bankruptcy proceedings." *United States* v. *Emory*, 314 U.S. 423, 427 (1941). When Congress amended the federal priority statute in 1978 to make clear that it does not apply in proceedings under the federal Bankruptcy Code, Congress did not state or imply that the priority statute would no longer apply in nonbankruptcy proceedings. Act of Nov. 6, 1978, Pub. L. No. 95-598, § 322(a), 92 Stat. 2678.

For the foregoing reasons and those stated in our opening brief, the judgment of the court of appeals should be reversed.

Respectfully submitted.

KENNETH W. STARR
Solicitor General

OCTOBER 1992

☆ U. S. GOVERNMENT PRINTING OFFICE: 1992 312324 60056

No. 91-1513
In the Supreme Court of the United States
October Term, 1992

UNITED STATES DEPARTMENT OF THE TREASURY and MITCHELL A. LEVINE, ASSISTANT COMMISSIONER,

Petitioners,

v.

GEORGE FABE, SUPERINTENDENT OF INSURANCE, STATE OF OHIO,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

BRIEF FOR THE STATES OF MICHIGAN ARIZONA, CALIFORNIA, FLORIDA, IDAHO, KANSAS, MAINE, MARYLAND, MINNESOTA, MONTANA, NEVADA, NEW JERSEY, NEW MEXICO, NORTH CAROLINA, PENNSYLVANIA, TENNESSEE, UTAH, AND WEST VIRGINIA IN SUPPORT OF RESPONDENT

FRANK J. KELLEY
Attorney General

Thomas L. Casey
Solicitor General
Counsel of Record

Harry G. Iwasko, Jr.
Janet A. VanCleve
Assistant Attorneys General

P. O. Box 30212
Lansing, Michigan 48909
(517) 373-1124
Attorneys for Amici Curiae

61

Grant Woods
Attorney General of Arizona
Office of the Attorney General
1275 West Washington
Phoenix, Arizona 85007

Daniel E. Lungren
Attorney General of California
Office of the Attorney General
1515 K Street
Sacramento, California 94244-2550

Robert A. Butterworth
Attorney General of Florida
Office of the Attorney General
Department of Legal Affairs
The Capitol
Tallahassee, Florida 32399-1050

Larry EchoHawk
Attorney General of Idaho
Office of the Attorney General
Statehouse, Room 210
Boise, Idaho 83720

Robert T. Stephan
Attorney General of Kansas
Office of the Attorney General
Judicial Center, Second Floor
Topeka, Kansas 66612

Michael E. Carpenter
Attorney General of Maine
Office of the Attorney General
State House
Augusta, Maine 04330

J. Joseph Curran, Jr.
Attorney General of Maryland
Office of the Attorney General
200 Saint Paul Place
Baltimore, Maryland 21202-2021

Hubert H. Humphrey, III
Attorney General of Minnesota
Office of the Attorney General
102 State Capitol
St. Paul, Minnesota 55155

Marc Racicot
Attorney General of Montana
Office of the Attorney General
Justice Building
215 North Sanders
Helena, Montana 59620

Frankie Sue Del Papa
Attorney General of Nevada
Office of the Attorney General
Heroes Memorial Building
Capitol Complex
Carson City, Nevada 89710

Robert J. Del Tufo
Attorney General of New Jersey
Office of the Attorney General
Division of Law
Richard Hughes Justice Complex
25 Market Street
Trenton, New Jersey 08625

Tom Udall
Attorney General of New Mexico
Office of the Attorney General
Bataan Memorial Building
Galisteo Street
P. O. Box 1508
Santa Fe, New Mexico 87504-1508

QUESTION PRESENTED

Whether a state statute governing the liquidation of an insolvent insurance company is a law "regulating the business of insurance" within the meaning of the McCarran-Ferguson Act.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

STATEMENT OF INTEREST OF AMICI CURIAE

Recent years have witnessed a dramatic increase in the number of insurance company insolvencies. Because the regulation of insurance has traditionally been a matter of exclusive state concern, the various states have constructed a complex and specialized regulatory framework for the rehabilitation and liquidation of insurers. While each state's insurance statute is different in some details, most of the states' insolvency laws are modeled after the uniform act developed by the National Association of Insurance Commissioners (NAIC).

In this case, the federal government seeks to supersede the Ohio insurance law which provides for an order of priority of claims against the remaining assets of an insolvent insurer. The United States

contends that the federal claim as obligee on certain bonds takes priority over all other claims, including those of other bond holders and policyholders. The amici curiae who join to file this brief represent states for whom approval of the federal priority now urged by the United States would seriously reduce their ability to protect their state's policyholders, profoundly drain their already scarce revenues, and severely disrupt the efficiency and stability of interstate, cooperative insurance company liquidations in which the state insurance commissioners, by law, serve as receivers.

Because the federal government has entrusted the power to regulate the insurance industry to the states, state

governments have accepted the concomitant responsibility to act as the ultimate protector of the policyholders -- an interest comparable to that of the federal government's interest in protecting depositors of banks and savings and loans. Much like the role played by the Federal Deposit Insurance Corporation in protecting bank depositors, all states have established guaranty funds for life and health insurance and for property and casualty insurance which act as a safety net for the prompt payment of policyholder claims in cases of insurance liquidations. These funds, created by state statute, pay the claims of the policyholders of the insolvent insurance company and then subrogate themselves to the aggregate claims paid.

That portion of the payments to policyholders which the guaranty funds are unable to collect from the insolvent company's assets is then assessed to all the insurance company members of the guaranty fund association, in which membership is mandated by law. The members are assessed their pro-rata share of the guaranty fund shortfall based on premiums written and in turn are permitted, in Michigan and in most other states, a 100% credit against state taxes. Thus, the shortage of funds with which to pay policyholder claims is subtracted from the tax revenues of the state. Since most states also have constitutional provisions requiring a balanced budget, this means that the shortfall in revenue must be captured from other sources.

In addition to the drain on state treasuries, assigning first priority to the federal claim, as urged by the United States, would interfere with the efficient distribution of the assets of the estate. Under the federal priority statute, state insurance commissioners, as receivers, would face potential personal liability for any claims paid before paying the federal government's claim. Accordingly, any prudent receiver of an insolvent insurance company with knowledge of taxes or other federal claims would delay paying any claims for fear that the ultimate determined debt owed to the federal government might be greater than the available assets of the receivership. If the position advanced by the United States is adopted by this Court, the distribution of the assets of

an insolvent insurer could be delayed by years.

Even if the guaranty funds could pay the claims of the policyholders, they would not be able to obtain asset advances from the receiver to do so, but would instead have to borrow funds to make the payments until such time as the assessments are levied and collected from the insurance companies, again passing the cost of insurance insolvencies to the state taxpayers.

Even in those few states, such as California, in which state priority statutes place federal claims above policyholder claims and which do not grant tax credits for guaranty fund contributions, a decision in favor of the United States would have serious repercussions. Such a

decision would infringe upon, if not defeat, the Uniform Insurer's Liquidation Act's eminently workable procedure, analogous to bankruptcy proceedir s, which places all assets and claims under the exclusive control of one state court.

In Burford v Sun Oil Co, 319 US 315 (1943), this court held that federal courts may properly decline to hear cases within their jurisdiction when to do so would impair the "independence of state governments in carrying out their domestic policy." Id. at 318.

Numerous federal opinions have relied on McCarran-Ferguson to find Burford abstention appropriate in claims against insolvent insurers involved in state liquidation proceedings under the Uniform Act. See, e.g. Law Enforcement Ins Co v

Corcoran, 807 F2d 38 (CA 2, 1986); Lac D'Amiante du Quebec v American Home Assurance Co, 864 F2d 1033 (CA 3, 1988); Martin Insurance Agency, Inc v Prudential Reinsurance Co, 910 F2d 249 (CA 5, 1990); Hartford Casualty Ins Co v Borg-Warner Corp, 857 F2d 699 (CA 10, 1988).

A decision for the United States in this case would thus invite federal courts to hear proceedings involving insurance companies in liquidation. Since most insurers have policyholders and assets in many states outside the state of domicile, state insurance commissioners will be forced to defend actions in a multitude of federal courts and will also face the possibility of the dissipation of assets through post-judgment attachments or levies. Payment

of claims through post-judgment proceedings could give these litigants a priority or preference, thereby encouraging all claimants to seek such "federal" assistance rather than complying with the state statutory scheme.

Amici states therefore urge the Court to consider the full effect of its decision in this case.

SUMMARY OF ARGUMENT

This case requires the interpretation of Section 2(b) of the McCarran-Ferguson Act, 15 USC § 1012(b). The section contains two distinct clauses: a primary clause that provides that no act of Congress shall supersede any state law regulating the business of insurance unless the act specifically relates to

the business of insurance; and a proviso, which provides that certain specified federal antitrust laws shall apply to the business of insurance "to the extent that such business is not regulated by state law." The primary clause requires a determination whether a state statute "regulates the business of insurance," while the proviso requires a narrow focus on a particular activity to determine whether that practice constitutes the "business of insurance."

The instant case involves a direct attack on a state statute under the federal superiority statute, 31 USC § 3713, and therefore requires analysis under the primary clause. A state statute "regulates the business of insurance" if it is aimed at protecting or regulating,

directly or indirectly, the relationship between the insurance company and the policyholder. SEC v National Securities, 393 US 453 (1969). The Ohio liquidation statute, which provides for the satisfaction of policyholder claims in the event of insolvency of an insurer, clearly meets the requirements for a state law "regulating the business of insurance."

Because the narrower exemption for the antitrust laws embodied in the proviso requires consideration of a particular activity of an insurer, this Court has developed a three-factor test to determine whether the activity is the "business of insurance." Union Labor Life Insurance v Pireno, 458 US 119 (1982). The Court has never applied the Pireno test to a state statute challenged

under McCarran-Ferguson, and has explicitly recognized that the proviso clause provides only a limited exemption in antitrust cases. Group Life & Health Insurance Co v Royal Drug Co, 440 US 205, 218, n 18 (1979). The Pireno factors are therefore inapplicable to this case.

The federal superiority statute does not apply to cases in the federal bankruptcy courts. The United States' claim in this case is therefore made possible only because insurance companies are exempt from the bankruptcy act. In making the exemption it is clear that Congress intended to prevent, not foster, federal encroachment in this area.

The fact that Congress used the words "No Act of Congress...." and made separate provision in McCarran-Ferguson for

the antitrust laws, as well as the National Labor Relations Act, the Fair Labor Standards Act and the Merchant Marine Act, demonstrate that the drafters intended no unspoken exception for the federal superiority statute.

ARGUMENT

INTRODUCTION

> The versatility with which argument inverts state and national power, each in alternation to ward off the other's incidence, is not simply a product of protective self-interest. It is a recurring manifestation of the continuing necessity in our federal system for accommodating the two great basic powers it comprehends.
>
> Prudential Insurance Co v Benjamin, 328 US 408 (1945).

This case results from a direct conflict between claims of state and federal authority involving interpretation of the

McCarran-Ferguson Act, 15 USC §§ 1011-1015, by which Congress, in 1945, ceded to the states the authority to regulate the business of insurance.

This Court has considered the McCarran-Ferguson Act on a number of occasions. In all recent cases coming before the Court, however, the Act has been employed as a defense by parties whose activities have allegedly violated federal law. Since the various states whose regulatory authority was asserted as a shield in those cases were not parties, their actual interest in the outcome, if any, cannot be determined from a reading of the cases. By contrast, the instant case presents a direct attack on the regulatory authority of the State of Ohio by the federal government.

The issue is fairly simple, though the statutory framework upon which its resolution depends is somewhat more complex. Upon the dissolution and liquidation of an insolvent insurance company, may the states regulate the order of priority of claims for the protection of policyholders and state taxpayers, or must the claims of the federal government take first priority?

The United States seeks priority for its claims under the authority of the federal superiority statute, 31 USC § 3713. That Act provides, in pertinent part:

> (a)(1) A claim of the United States shall be paid first when -
>
> (A) a person indebted to the Government is insolvent and -
>
> (i) a debtor without enough property to pay all debts makes a voluntary assignment of property;

(ii) property of the debtor, if absent, is attached; or

(iii) an act of bankruptcy is committed.

(2) This subsection does not apply to a case under Title 11.

Subsection (a)(2) of the Act provides that federal superiority is not available in cases in federal bankruptcy court under Title 11. Thus, the United States' claim against Ohio Insurance Commissioner Fabe as liquidator of American Druggists Insurance Company in this case arises only because insurers are specifically excluded from Chapter 7 and Chapter 11 of the federal bankruptcy law. 11 USC § 109(b)(3); 109(d). The long-standing exclusion of insurance liquidations from the federal bankruptcy courts, however, was made in deference to the regulatory authority of the states. The Senate

Report on the Bankruptcy Reform Act of 1978, P.L. 95-598, states:

> Banking institutions and insurance companies engaged in business in this country are excluded from liquidation under the bankruptcy laws because they are bodies for which alternate provision is made for their liquidation under various State or Federal regulatory laws.
>
> S. Rep. No. 989, 95th Cong. 2d Sess. 31 (1978).

The rationale was further stated by the United States District Court for the Central District of California as follows:

> In the case of insurance companies, most states have enacted regulatory schemes which include provisions for insolvency. Since these schemes are designed to protect the interests of policy holders in the event of insolvency, Congress in enacting Section 4 [11 USC § 22, the predecessor to § 109(b) of the present Act] decided that liquidation of insurance companies should be left to the states. _In re Union Guaranty & Mortgage Co._, 75 F.2d 984 (2d Cir. 1935); _In re Supreme Lodge of the_

> Masons Annuity, 286 F. 180, 184 (N.D.Ga. 1923). Since the reorganization of an insurance company or its adjudication as a bankrupt under the Act would preempt state liquidation proceedings for that company, Congress enacted Section 4 to preserve the exclusive jurisdiction of the states over the liquidation of insurance companies and to prevent the reorganization of insurance companies or their adjudication as bankrupts. See Woolsey v Security Trust Co., 74 F.2d 334, 337 (5th Cir. 1934).
>
> In re Equity Funding Corp of America, 396 F Supp 1266, 1275 (CD Cal, 1975), aff'd 519 F2d 1274 (CA 9, 1975).

There is, therefore, some irony in the fact that the State of Ohio, having enacted a comprehensive insurer liquidation statute, now finds the priorities established by the state for the protection of policyholders and other claimants subject to an attack by the federal government made possible by the very exemption from the federal bankruptcy laws

that was enacted to prevent, not facilitate, federal encroachment on state regulatory authority. Clearly, Congress did not intend such a result.

In resisting the federal superiority claim in this case, Commissioner Fabe has relied on the McCarran-Ferguson Act's provision which states that laws "regulating the business of insurance" may not be superseded by federal laws which do not specifically state their applicability to insurance. Since the federal superiority statute, quoted above, does not explicitly provide for its application to insurance liquidations, the controversy in the lower courts has centered on the question whether the Ohio statute providing for the liquidation of insolvent insurers is a law "regulating the

business of insurance," as that phrase was intended to be understood by the Congress that enacted McCarran-Ferguson.

The Sixth Circuit Court of Appeals in this case, and most other courts which have considered this issue, have applied a three-factor test articulated in Union Labor Life Insurance Co v Pireno, 458 US 119 (1982). See, e.g. Gordon v US, 668 F Supp 483 (D.Md. 1987), aff'd 846 F2d 272 (CA 4, 1988); State of Idaho ex rel Soward v US, 858 F2d 445 (CA 9, 1988), but see In the Matter of Union Indemnity Insurance Co, 551 NYS 2d 446 (Sup Ct 1990), aff'd sub nom Curiale v US, 170 AD2d 342, 566 NYS 2d 853 (1991), Petition for cert pending, No. 91-1347. In this case, the United States argues that the application of the Pireno factors

requires this Court to reverse the decision of the Sixth Circuit Court of Appeals. Amici States urge the Court to consider their contention that Pireno's three-factor test does not, and was never intended to, apply to the type of case now presented.

Amici contend that the structure of the McCarran-Ferguson Act, its legislative history, and this Court's previous opinions demonstrate that the Act's major purpose is to provide broad protection from federal interference with state regulation of the insurance industry. Its secondary purpose is to ensure that the federal antitrust laws apply to the activities of insurance companies unless the specific practice at issue constitutes the "business of insurance" and is

regulated by the state. Under this analysis, the Ohio liquidation statute may not be superseded by the federal superiority statute.

I.

CONGRESS INTENDED THE PRIMARY CLAUSE OF SECTION 2(b) OF THE McCARRAN-FERGUSON ACT TO PROVIDE A BROADER EXEMPTION FROM FEDERAL REGULATION THAN THAT OF THE PROVISO.

The starting point in any case involving construction of a statute is the language of the Act itself. St Paul Fire & Marine Insurance Co v Barry, 438 US 531 (1978). The preamble to the McCarran-Ferguson Act sets forth its purpose:

> Congress hereby declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several states.
>
> 15 USC § 1011.

Section 2(a) states:

> (a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.
>
> 15 USC § 1012(a).

It is the construction of section 2(b) which is at issue in the present case. Amici believe that it is critical for the resolution of this conflict to note that section 2(b) contains two distinct clauses. The primary clause establishes a broad prohibition:

> No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: ...

This sweeping language is followed by a proviso which applies specifically to three federal antitrust statutes. The proviso states in pertinent part:

> Provided, That after June 30, 1948, the ... Sherman Act, and ... the Clayton Act, and the ... Federal Trade Commission Act ... shall be applicable to the business of insurance to the extent that such business is not regulated by State law.
>
> 15 USC § 1012(b).

Amici contend that the correct analysis to be applied under Section 2(b) depends upon whether the case arises under the primary clause or under the proviso.

A. BECAUSE THE PROVISO TO SECTION 2(b) APPLIES ONLY TO THE ANTITRUST LAWS, THE MORE GENERAL PROHIBITION OF THE PRIMARY CLAUSE NECESSARILY AFFORDS A BROADER EXEMPTION THAN THE PROVISO.

The McCarran-Ferguson Act was passed in 1945 in response to this Court's decision in United States v South-Eastern Underwriters Assoc, 322 US 533 (1944), which had overruled previous precedent and held that the transaction of insurance was interstate commerce. Prior to that decision, the regulation of insurance was considered the exclusive prerogative of the states.

As finally passed, the Act was the result of compromise. Generally speaking, the House of Representatives preferred to exempt the insurance industry from any federal regulation whatsoever, while the Senate was reluctant to provide for insurers a total exemption from the antitrust laws. (See, e.g. remarks of Sens. Murdock and McCarran, 91 Cong. Rec. 1484-1485 (1945); SEC v National Securities, 393 US 453, 458 (1969)). As

enacted, the law provided a three-year moratorium from the application of the antitrust laws to the insurance industry. During the moratorium it was expected that the states would enact their own antitrust-type legislation to regulate the activities of the industry. (See, e.g. remarks of Sens. McCarran, Murdock and Ellender, 91 Cong. Rec. 1442 (1945).) Following the moratorium, under the proviso clause of section 2(b), the three specified antitrust laws would be applicable to the business of insurance "to the extent that such business is not regulated by State law."

The primary clause of Section 2(b) is cast in prohibitive language: "No Act of Congress shall ...." The language of the proviso, by contrast, is cast in the

affirmative: "the [antitrust laws] shall be applicable ...." This textual difference cannot have been inadvertent, given Congressional concern that the insurance industry remain subject to antitrust regulation, whether by the federal government or the states, and its declaration that the "continued regulation ... by the several States of the business of insurance [was] in the public interest." 15 USC § 1011. The interpretation of Section 2(b) most consistent with its express terms, therefore, is that the words of the proviso making the antitrust laws applicable "to the extent such business is not regulated by state law," suggest that Congress intended the federal antitrust laws to fill in any "gaps" left unregulated by the states. (See, e.g. remarks of Sens. O'Mahoney, White,

McCarran and Murdock, 91 Cong. Rec. 1444 (1945).)

This interpretation is also supported by a careful reading of the prior opinions of this Court.

B. THIS COURT HAS EMPLOYED DIFFERENT ANALYSES TO CASES UNDER THE TWO CLAUSES OF SECTION 2(b).

Prior decisions of this Court indicate that the nature of the analysis employed is quite different depending upon whether the case arises under the primary clause of section 2(b) or under the antitrust proviso. When considering the primary clause, the Court has determined, in the first instance, whether a state statute regulates the business of insurance, and, if so, whether the proposed invocation of federal authority

"invalidates, impairs or supersedes" the state law. When considering the proviso, the Court has examined a particular activity engaged in by an insurer, and sought to be regulated by the federal antitrust laws, and has determined whether that single activity constitutes the business of insurance. With regard to the three-part test developed in Group Life & Health Insurance Co v Royal Drug Co, 440 US 205 (1979), and articulated in Pireno, supra, the Court has applied the three criteria only to antitrust cases, and has clearly stated in each instance that it was articulating a test to be applied to antitrust cases under the proviso clause of Section 2(b) of McCarran-Ferguson.

This case, therefore, presents the Court with an opportunity to clarify the

distinction between the broad language of the primary clause directed to "Act[s] of Congress" in general, and the specific and more limited exemption for the antitrust statutes contained in the proviso.

1. <u>UNDER THE PRIMARY CLAUSE OF SECTION 2(b), A STATUTE REGULATES THE BUSINESS OF INSURANCE IF IT IS AIMED AT PROTECTING OR REGULATING, DIRECTLY OR INDIRECTLY, THE RELATIONSHIP BETWEEN THE INSURANCE COMPANY AND THE POLICYHOLDER.</u>

In <u>SEC</u> v <u>National</u> <u>Securities</u>, 393 US 453 (1969), the Court considered the general prohibition contained in the primary clause of section 2(b). The Securities and Exchange Commission had alleged violations of federal securities law by an insurance company in connection with its merger with another insurer. It was alleged that the defendant companies had

made misrepresentations to stockholders in seeking their approval of the merger. The companies contended that, because the Arizona Insurance Commissioner was charged with the responsibility for protecting stockholders of insurance companies, the McCarran-Ferguson Act barred the SEC prosecution. The defendants pointed to an Arizona law aimed at regulating the merger of insurance companies, which required the Commissioner to find that the merger would not be "inequitable to the stockholders of any domestic insurer" or otherwise "contrary to law" before granting his approval.

When the matter reached this Court, it was held that the section of the Arizona statute which was designed to protect the interests of stockholders was

not a law regulating the "business of insurance." "Insurance companies may do many things which are subject to paramount federal regulation;" the Court stated, "only when they are engaged in the 'business of insurance' does the statute apply." Id. at 459-460. The Court went on to suggest the parameters of the meaning of the term "business of insurance":

> The relationship between insurer and insured, the type of policy which could be issued, its reliability, interpretation, and enforcement--these were the core of the "business of insurance." Undoubtedly, other activities of insurance companies relate so closely to their status as reliable insurers that they too must be placed in the same class. But whatever the exact scope of the statutory term, it is clear where the focus was--it was on the relationship between the insurance company and the policyholder. Statutes aimed at protecting or regulating this relationship, directly or indirectly, are laws regulating the "business of insurance."

Id. at 460. (Emphasis added.)

The Court concluded:

> The crucial point is that here the State has focused its attention on stockholder protection; it is not attempting to secure the interests of those purchasing insurance policies. Such regulation is not within the scope of the McCarran-Ferguson Act.

Id. Therefore, the Court held that the SEC prosecution was not barred by the Act.

The Circuit Court in the instant case, and the courts in Gordon and Soward, supra, did not discuss the fact that the National Securities Court considered a second section of the Arizona insurance law and found that that section did regulate the business of insurance. The second question arose because of the remedy sought by the SEC for the alleged

misrepresentation -- an unwinding of the merger of the two insurers. The federal authority to impose such a remedy was separately challenged as violating McCarran-Ferguson.

In Part II of its opinion, the Court noted that the SEC was seeking to unwind a merger which had been approved by the Arizona Director of Insurance, as required by state law:

> The fact remains, however, that the State of Arizona has approved a merger between two insurance companies which, as a matter of remedies, the Securities and Exchange Commission seeks to unwind. Moreover, Arizona has approved the merger not only under its laws relating to insurance securities but also in its capacity as licensor of insurers within the State. The applicable statute requires the State Director of Insurance to find that the proposed merger would not "substantially reduce the security of and service to be rendered to policyholders" before he gives his approval. Ariz Rev Stat Ann § 20-731B3 (Supp 1969). <u>This section of the statute clearly relates to the "business of insurance</u>." ...

<u>Id</u>. at 462. (Emphasis added.)

The fact that this second holding of the <u>National Securities</u> Court has generally escaped notice or comment is perhaps explained by the fact that even though the court found the statute aimed at the protection of policyholders (as opposed to stockholders) was a law regulating the business of insurance, the majority nevertheless found that the proposed SEC remedy was not barred by McCarran-Ferguson.

Under the circumstances of that case, the Court found the remedy was not prohibited because its application would not "invalidate, impair or supersede" the state law. The Court stated:

> ... Arizona has not commanded something which the Federal Government seeks to prohibit. It has permitted respondents to consummate the merger;

> it did not order them to do so. In this context, all the Securities and Exchange Commission is asking is that insurance companies speak the truth when talking to their shareholders. The paramount federal interest in protecting shareholders is in this situation perfectly compatible with the paramount state interest in protecting policyholders ....

_Id_. at 463.

Thus, not finding a direct conflict between federal and state authority, the Court held that unwinding the merger by way of remedy for the alleged securities violation was not barred by the McCarran-Ferguson Act.

Under the primary clause of Section 2(b) of the Act, then, this Court's analysis has centered on the purpose of the state statute. Where the statute directly or indirectly regulates and protects the relationship between insurer

and insured, _National Securities_ teaches that the state law is one "regulating the business of insurance" for purposes of the prohibition against federal encroachment provided by the McCarran-Ferguson Act. The United States therefore overgeneralizes when it asserts that the holding of _National Securities_ is that "state regulation of an insurance company merger is not the business of insurance." Brief for the United States, p 14.

2. IN CONTRAST, UNDER THE PROVISO CLAUSE OF SECTION 2(b), A PARTICULAR ACTIVITY CONSTITUTES THE BUSINESS OF INSURANCE IF IT MEETS THE THREE-PART PIRENO TEST.

In _Group Life & Health Insurance Co v Royal Drug Co_, 440 US 205 (1979), this Court considered a case under the proviso clause of section 2(b) and explicitly recognized that the nature of the inquiry

depends upon whether the case is governed by the primary clause or by the proviso. In that case, a Texas pharmacy brought suit against an insurer, alleging that certain agreements between the insurer and other pharmacies violated section 1 of the Sherman Antitrust Act. In its defense, the insurer claimed that, under McCarran-Ferguson, its activities were exempt from the reach of federal antitrust laws.

In holding that the activities of the insurer in entering into the pharmacy agreements were not the "business of insurance," the majority emphasized, in a footnote, that it was considering a more limited antitrust exemption contained in the proviso clause of section 2(b):

> There is no question that the primary purpose of the McCarran-Ferguson Act was to preserve state regulation of

> the activities of insurance companies, as it existed before the South-Eastern Underwriters case. The power of the States to regulate and tax insurance companies was threatened after that case, because of its holding that insurance companies are in interstate commerce. The McCarran-Ferguson Act operates to assure that the States are free to regulate insurance companies without fear of Commerce Clause attack. <u>The question in the present case, however, is one under the quite different secondary purpose of the McCarran-Ferguson Act--to give insurance companies only a limited exemption from the anti-trust laws</u>.
>
> The repeated insistence in the dissenting opinion that the McCarran-Ferguson Act should be read as protecting the right of the States to regulate what they traditionally regulated is thus entirely correct--and entirely irrelevant to the issue now before the Court .... For <u>the question here is not whether the McCarran-Ferguson Act made state regulation of these Pharmacy Agreements exempt from attack under the Commerce Clause. It is the quite different question whether the Pharmacy Agreements are exempt from the antitrust laws</u>.

<u>Id</u>. at 218, n 18. (Emphasis added.)

<u>Royal Drug</u> was followed by <u>Union Labor Life Insurance Co</u> v <u>Pireno</u>, 458 US

119 (1982), in which this Court was asked to consider whether an insurer's peer review practices were exempt from antitrust scrutiny under the proviso clause of section 2(b) of McCarran-Ferguson. The Court articulated a three-factor analysis drawn from Royal Drug:

> In sum, Royal Drug identified three criteria relevant in determining whether a particular practice is part of the "business of insurance" exempted from the antitrust laws by § 2(b): first, whether the practice has the effect of transferring or spreading a policyholder's risk; second, whether the practice is an integral part of the policy relationship between the insurer and the insured; and third, whether the practice is limited to entities within the insurance industry.

Pireno, supra, at 129.

The Pireno court clearly stated that the purpose of the three-part test was to determine the applicability of McCarran-

Ferguson to antitrust cases and to determine whether a particular practice constituted the "business of insurance." It was not developed to determine whether a state statute "regulates the business of insurance." The application of the Pireno test to cases arising under the primary clause of section 2(b) is therefore inappropriate under this Court's prior decisions, which have recognized the distinction drawn by the structure of the Act and its legislative history.

The United States suggests that the use of the Pireno factors in two cases considering preemption of state law under the federal Employee Retirement Income Security Act of 1974 (ERISA) (29 USC § 1001 et seq) demonstrates that the Pireno test was not intended to apply

only to antitrust cases under McCarran-Ferguson. Brief for the United States, p 17, fn 7. In Metropolitan Life Insurance Co v Massachusetts, 471 US 724 (1985), and Pilot Life Insurance Co v Dedeaux, 481 US 41 (1987), the Court was called upon to interpret ERISA's "saving clause" which excepts from federal preemption under that Act any state law which "regulates insurance." 29 USC § 1144(b)(2)(A). In deciding whether the particular laws under consideration in those cases were laws regulating insurance, the Court "borrowed" the three-factor Pireno test.

Amici contend that the fact that the Court in Metropolitan Life and Pilot Life adopted the Pireno test in the interpretation of another act has no applicability whatsoever in the interpretation of the McCarran-Ferguson Act, although it might be noted that the Metropolitan Life case preserved the preeminence of the state statute.[1] The fact that the Court found Pireno useful in an unrelated context has no application to the question raised in this case.

One might argue that Pireno should apply to the interpretation of both clauses of section 2(b) because both the primary clause and the proviso refer to the "business of insurance." Upon further consideration, however, it is clear that the three-factor test is suited only to

[1]At issue in Pilot Life were state common-law tort decisions which the Court unanimously held were not "laws regulating insurance" for purposes of the ERISA saving clause.

the examination of a practice or activity which might run afoul of the antitrust laws as addressed in the proviso.

In the area of taxation, for example, although the primary clause exempts state taxation of the "business of insurance" from federal interference, taxes imposed on insurance companies as a whole are exempted, not only those taxes of the particular activities of the insurer that meet the Pireno criteria. Western & Southern Life Ins Co v Board of Equalization, 451 US 648 (1981).

This Court has also stated that state statutes requiring the licensing of insurance agents are laws regulating the business of insurance, and are exempt from Commerce Clause attack under the primary clause of Section 2(b) of

McCarran-Ferguson. Robertson v California, 328 US 440 (1945). In both Western & Southern Life and Robertson, while the insurance companies and the insurance agents obviously engage in some activities which would meet the Pireno standard, the taxation and the licensing statutes are not limited to those activities alone.

Finally, Section 4 of the McCarran-Ferguson Act states that the National Labor Relations Act, the Fair Labor Standards Act and the Merchant Marine Act apply to the business of insurance. It is obviously impossible to apply the labor laws solely to those activities of insurance companies defined as the business of insurance by Pireno, and therefore a broader interpretation of the phrase is necessary.

It is clear, then, from the cases decided by this Court and the structure of the McCarran-Ferguson Act itself, that the requirement of the proviso--that the antitrust laws apply to the business of insurance "to the extent that such business is not regulated by state law"--requires, in antitrust cases alone, a more specific focus on the precise practice or activity challenged--a focus not required in the consideration of other provisions of the Act.

The gravamen of a statute which regulates the business of insurance for purposes of the primary clause of section 2(b), then, is whether, directly or indirectly, it regulates the relationship between insurer and insured. National Securities, supra.

Clearly, the Ohio insurer liquidation statute meets that definition. By providing a mechanism for the state to take control of the assets of an insolvent insurer, and a system for applying those assets to the claims of policyholders, it has as its primary purpose the protection of the insured. Under the precedents of this Court, the Ohio statute regulates the business of insurance within the meaning of the primary clause of section 2(b) of the McCarran-Ferguson Act and may not be superseded by the federal law.

II.

SINCE, IN THE McCARRAN-FERGUSON ACT, CONGRESS DID NOT MAKE AN EXCEPTION FOR THE FEDERAL SUPERIORITY STATUTE, THAT ACT IS INCLUDED IN THE WORDS, "NO ACT OF CONGRESS".

Prior to the passage of the McCarran-Ferguson Act, this Court, in Knott v US,

298 US 544 (1935), held that the predecessor to the federal superiority statute could be successfully asserted in a state proceeding to liquidate the assets of a surety company.

The United States has claimed that because the avowed purpose of McCarran-Ferguson was to return to the status quo prior to the South-Eastern Underwriters case, the Knott holding mandates that federal superiority must prevail regardless of the passage of the Act and of half a century since Knott.

The following passage from the House Report on the Act is generally cited for the proposition that McCarran-Ferguson was intended only to nullify South-Eastern Underwriters and to work no other change:

> It is not the intention of Congress in the enactment of this legislation to clothe the States with any power to regulate or tax the business of insurance beyond that which they had been held to possess prior to the decision of the United States Supreme Court in the Southeastern Underwriters Association case. Briefly, your committee is of the opinion that we should provide for the continued regulation and taxation of insurance by the States, subject, always, however, to the limitations set out in the controlling decisions of the United States Supreme Court, as for instance, in Allgeyer v. Louisiana (165 U.S. 578); St. Louis Cotton Compress Co. v. Arkansas (260 U.S. 346); and Connecticut General Insurance Co. v. Johnson (303 U.S. 77).
>
> H.R. Rep. No. 143, 79th Cong., 1st Sess. 3 (1945).

The legislative history upon which the United States relies supports Ohio and the Amici States' position, not the United States'. An examination of the three cases cited in the House Report quoted above demonstrates that the

drafters were not considering an unspoken exemption for certain additional acts when they stated that McCarran-Ferguson was not enacted to give the states greater regulatory power than they had had prior to the South-Eastern Underwriters decision. In all three of the cases cited in the report, this Court had held that a state could not assert its regulatory authority over transactions which occurred outside its borders. By citing these three cases, the House Report made clear that it was this Court's interpretation of the reach of the states' authority (which, at the time of those earlier decisions, was not questioned) that Congress sought to preserve and not the application of unnamed federal acts. Further, the legislative history contains an express statement by

the bill's sponsor that the prohibition applied to all acts of Congress existing at the time of its passage:

> MR. MURDOCK. I invite the Senator's attention to paragraph (b) of section 2 of the bill, reading as follows:
>
> (b) No act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such act specifically so provides.
>
> That part of the bill is applicable, is it not to Federal statutes now in existence?
>
> MR. FERGUSON. That is the purpose of the section.
>
> 91 Cong. Rec. 479 (1945).

There is, however, no need to rely on legislative history to interpret the words of an Act which are unmistakably clear. Section 2(b) begins with the words, "No Act of Congress ...." The

United States would argue that those words were intended to mean no act of Congress except the superiority statute. This in spite of the fact that Congress did, in section 2(b) and elsewhere in the Act, make provision for a number of statutes which were to be given a partial exemption from the broad prohibition of the primary clause of Section 2(b). In section 4, as previously noted, the drafters specified that "Nothing contained in this chapter shall be construed to affect in any manner the application to the business of insurance" of the National Labor Relations Act, the Fair Labor Standards Act and the Merchant Marine Act. 15 USC § 1014.

There is, therefore, no support for the position of the United States that

the superiority statute was implicitly excepted from the McCarran-Ferguson Act.

CONCLUSION

For all of the reasons stated above, Amici Curiae urge this Court to hold that the Ohio insurer liquidation statute is a law regulating the business of insurance under the McCarran-Ferguson Act, and may not be superseded by 31 USC § 3713.

Respectfully submitted,

FRANK J. KELLEY
Attorney General

Thomas L. Casey
Solicitor General
Counsel of Record

Harry G. Iwasko, Jr.
Janet A. VanCleve
Assistant Attorneys General

P.O. Box 30212
Lansing, Michigan 48909
(517) 373-1124

Attorneys for Amici Curiae

Lacy H. Thornburg
Attorney General of N. Carolina
Office of the Attorney General
Department of Justice
2 East Morgan Street
P.O. Box 629
Raleigh, North Carolina 27602

Ernest D. Preate, Jr.
Attorney General of Pennsylvania
Office of the Attorney General
Strawberry Square
Harrisburg, Pennsylvania 17120

Charles W. Burson
Attorney General of Tennessee
Office of the Attorney General
450 James Robertson Parkway
Nashville, Tennessee 37243

Paul Van Dam
Attorney General of Utah
Office of the Attorney General
State Capitol
Salt Lake City, Utah 84114

Mario J. Palumbo
Attorney General of West Virginia
Office of the Attorney General
Building 1, Room E-26
Capitol Complex
Charleston, West Virginia 25305

No. 91-1513 (5)

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

UNITED STATES DEPARTMENT OF THE TREASURY AND
MITCHELL A. LEVINE,
ASSISTANT COMMISSIONER,

Petitioners,

v.

GEORGE FABE, SUPERINTENDENT OF INSURANCE,
STATE OF OHIO,

Respondent.

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

**AMICUS CURIAE BRIEF OF
JAMES A. GORDON, SPECIAL DEPUTY
STATE INSURANCE COMMISSIONER OF MARYLAND
FOR RESPONDENT**

Paul W. Grimm*
Mary Alice McNamara
Gina M. Harasti
NILES, BARTON & WILMER
111 S. Calvert Street
1400 Legg Mason Tower
Baltimore, Maryland 21202
(410) 783-6300

**Counsel of Record for Amicus Curiae*

31

TABLE OF CONTENTS

TABLE OF AUTHORITIES

No. 91-1513

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1992

UNITED STATES DEPARTMENT OF THE TREASURY AND MITCHELL A. LEVINE, ASSISTANT COMMISSIONER, PETITIONERS

v.

GEORGE FABE, SUPERINTENDENT OF INSURANCE, STATE OF OHIO, RESPONDENT

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

AMICUS CURIAE BRIEF OF JAMES A. GORDON, SPECIAL DEPUTY STATE INSURANCE COMMISSIONER OF MARYLAND FOR RESPONDENT

INTEREST OF THE AMICUS CURIAE

Amicus Curiae, James A. Gordon, a Special Deputy State Insurance Commissioner of Maryland, with powers derived from the Maryland Insurance Code, Md. Ann. Code art. 48A, §§ 133(5), 145, files this Amicus Curiae brief in support of the Respondent. Mr. Gordon is Receiver for Eastern Indemnity Company of Maryland and other insolvent insurance companies in Maryland. Mr. Gordon's interest in this matter originates from his role as plaintiff/appellant in Gordon v. United States Department of the Treasury, 668 F. Supp. 483 (D. Md. 1987), aff'd, 846 F.2d 272, (4th Cir.), cert. denied, 488 U.S. 954 (1988), and continues to the present due to his status as Receiver for other insolvent insurance companies in the State of Maryland.

The primary purpose of Congress in enacting the McCarran-Ferguson Act, 15 U.S.C. §1011 et seq., was to ensure that the regulation of the business of insurance remained a matter of state - not federal - law and that state regulation would be accomplished without federal interference. As this Court has itself recognized, one of the important goals of state insurance regulation is ensuring the solvency of insurance companies. Securities and Exchange Commission v. Variable Annuity Life Ins. Co. of America., 359 U.S. 65, 77 (1959) (Brennan, J., concurring). Indeed, insurance is nothing more than a promise of future payments upon the occurrence of a covered loss, a promise which is completely empty unless the company is viable enough to pay claims at the time of loss. The

comprehensive regulatory procedures of the Maryland Insurance Code, like those in virtually every other state, are aimed at fulfilling the promise of insurance by seeing to it that claims of policyholders, insureds and beneficiaries receive priority payment in the event of insurer insolvency. These state regulations, therefore, enable policyholders to receive the benefits promised by their insurance policies when they otherwise would not, because of the insolvency of the company. Because the ability of an insurer to pay a covered claim is at the heart of the relationship between the insurer and the insured,[1] state insurance code liquidation provisions, designed to assure the reliability and enforcement of insurance policies, do regulate the "business of insurance" and, accordingly, come within the aegis of the McCarran-Ferguson Act's prohibition against federal interference. No greater interference can be imagined than that worked by the federal "super priority" of 31 U.S.C. §3713.

Finally, Mr. Gordon's interest in this case as amicus curiae stems from the existing serious uncertainty with respect to the definition of the term "business of insurance," as it is used in the McCarran-Ferguson Act. This uncertainty exists because the decisions of this Court

---

1/ Union Labor Life Ins. Co. v. Pireno, 458 U.S. 119, 132 (1982) (policyholder's "only concern is whether his claim is paid, not why it is paid.").

interpreting the McCarran-Ferguson Act have not squarely construed the primary purpose of the Act in thirty years. Instead, this Court's recent decisions construing the Act have been confined to the altogether different and secondary antitrust exemption purpose, without clarifying the limited nature of these decisions. Consequently, Mr. Gordon recognizes the need for prompt guidance from this Court to lower federal courts which are ever-increasingly struggling with this important issue.

SUMMARY OF ARGUMENT

A.1. Resolution of the issues presented in this case turns on the meaning of the phrase "business of insurance" which is used, but not defined, in the McCarran-Ferguson Act. The legislative history of the McCarran-Ferguson Act demonstrates congressional concern over insurer insolvency. An insurer's ability to pay its policyholders' claims was considered by Congress to be the "business of insurance" when the Act was passed. In essence, the solvency of the insurer is critical to an insurer fulfilling its promise to pay the policyholder upon the happening of a certain event. See 91 Cong. Rec. 1481 (1945); 90 Cong. Rec. 6526, 6564-65 (1944).

2. Learned treatises also provide well-reasoned analyses of the meaning of the phrase "business of insurance." The payment of losses to policyholders, even in the event of insolvency of the insurer, has been called the raison d'etre of insurance. 2 G. Richards, The Law of Insurance, §207, Selection and Control of the Risk (5th ed. 1952). Scholars consistently link the

assumption of the risk factor with the payment of claims once filed, theorizing that without both of these factors insurance does not exist. Thus, it has been repeatedly expressed in insurance treatises that the goal of insurance regulation is the solvency of insurers. State regulatory procedures designed to fulfill the fundamental goals of insurance through the priority payment of policyholder claims when an insurer becomes insolvent is most decidedly the "business of insurance."

B. Federal courts have directly addressed what activity constitutes the "business of insurance" under the McCarran-Ferguson Act, in cases involving state insurance liquidation receiverships. In deciding whether abstention is appropriate pursuant to Burford v Sun Oil Co., 319 U.S. 315 (1943), these courts consistently respect the comprehensive frameworks enacted by the states to regulate the liquidation of insolvent insurers and the payment of claims against them. The McCarran-Ferguson Act's delegation of insurance regulation to the states has been held to cover state regulation of insolvent insurance companies. Federal Court deference to comprehensive state regulation for insurance company liquidations is probative of the general understanding and interpretation given to the McCarran-Ferguson Act's phrase "business of insurance."

C. The McCarran-Ferguson Act promotes two distinct purposes. The broad, primary purpose was to continue state regulation of the business of insurance. Group Life & Health Insurance Co. v. Royal Drug Co., 440 U.S. 205 (1979). The secondary, and

narrower, purpose was to give insurance companies a narrow antitrust exemption to enable them to engage in cooperative rate making. Id. The three-prong Pireno test articulated by this Court to define the phrase "business of insurance" in the McCarran-Ferguson Act evolved in response to insurance company attempts to circumvent antitrust laws by invoking the McCarran-Ferguson Act. Each of the three cases decided by this Court, from which the Pireno test derived, involved the secondary antitrust purpose of the McCarran-Ferguson Act and not the primary regulatory purpose of that Act. See Union Labor Life Insurance Co. v. Pireno, 458 U.S. 119 (1982); Group Life & Health Insurance Co. v. Royal Drug Co., 440 U.S. 205 (1979); Securities & Exchange Commission v. National Securities, Inc., 393 U.S. 453 (1969). The present case involves interpretation of the primary, regulatory function of the McCarran-Ferguson Act. In this context, the test for determining whether the "business of insurance" is involved should give equal recognition to the regulatory purpose of the Act, which includes protection of the ability of the states to fulfill their paramount responsibility in insurance regulation - insurer solvency and payment of policyholder claims even in the event of insurer insolvency.

ARGUMENT

A. THE LEGISLATIVE HISTORY OF THE MCCARRAN- FERGUSON ACT OF 1945 AND LEARNED TREATISES DEMONSTRATE THAT STATE INSURANCE CODE PROVISIONS ESTABLISHING THE PRIORITY FOR PAYMENT OF CLAIMS AGAINST INSOLVENT INSURERS MANIFESTLY REGULATE

THE "BUSINESS OF INSURANCE"

1. In General:

The major premise of the Solicitor General's brief is that through the Supremacy Clause of the United States Constitution,[2] the federal super priority statute[3] preempts Ohio insurance code insolvency provisions governing payment of policyholder and other claims.[4] The Government asserts further that the Ohio statute is not shielded from this preemption by the McCarran-Ferguson Act because it does not specifically relate to the business of insurance.

The correctness of the Government's argument hinges on the definition of the "business of insurance" as set out in the McCarran-Ferguson Act, which states in relevant part:

> (a) The business of insurance,...shall be subject to the laws of the several States...
>
> (b) No Act of Congress shall be contrued to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance... unless such Act specifically relates to the business of insurance.

2/ U.S. Const. art. VI, cl. 2 provides in part: "[T]he Laws of the United States...shall be the supreme law of the land."

3/ 31 U.S.C. §3713.

4/ The Ohio Insurers Supervision, Rehabilitation and Liquidation Act, Ohio Rev. Code Ann. §§ 3903.02(D) and 3903.42 (Anderson 1989).

15 U.S.C. §1012 (emphasis added). The Solicitor General argues that the state insurance code provisions which assign priorities for payment of claims against insolvents do not involve the "business of insurance." Contrary to the Government's belief,[5] this key phrase is not defined in the McCarran-Ferguson Act, and its meaning cannot be determined simply from reading the Act.[6] Accordingly, this Court has instructed that resort to both the legislative history of the Act and

5/ Brief for Petitioners at 7.

6/ See Fabe v. U.S. Department of Treasury, 939 F.2d 341 at 344 (6th Cir. 1991) ("although the Act exempts from federal preemption only those state regulations which concern the 'business of insurance,' neither the Act nor its legislative history is particularly enlightening as to the meaning of the term.") (citing Securities & Exchange Commission v. National Securities, Inc., 393 U.S. 453, 459 (1969)).

authoritative treatises on insurance are necessary to discern the meaning of this all important phrase. Group Life & Health Insurance Co. v. Royal Drug Co., 440 U.S. 205, 210-212 (1979).

2. **The Legislative History:**

The Solicitor General's analysis of the legislative history of the McCarran-Ferguson Act[7] does not describe fully the concerns of Congress when enacting the legislation. The legislative history of the McCarran-Ferguson Act demonstrates that Congress recognized that an insurance policy is an empty promise unless the company issuing it is capable of paying claims when made, and that state regulations aimed at this concern did involve the business of insurance. This Court noted such congressional concern in Royal Drug by observing that the Congress which enacted the McCarran-Ferguson Act was aware that the very purpose of insurance regulation was concern over insurer insolvency. Royal Drug, 440 U.S. at 221.

Perhaps the clearest expression of this concern by Congress came from Senator Ferguson, the co-author of the McCarran-Ferguson Act, who addressed it squarely:

> The sale of insurance is not the same as the sale of an article in a store. When one buys an article in a store, he brings it home with him. In the case of insurance, he buys a promise to pay upon the happening of a certain event, and that event may be the burning of his home. If the company is not sound and solvent at the time the house burns, or at the time the claim is made, there is not insurance at all. That is what we have tried to avoid.

7/ Brief for Petitioners at 19-20.

91 Cong. Rec. 1481 (1945) (emphasis added). At 90 Cong. Rec. 6564-65 (1944), Representative Vorys remarked:

> The companies have the sacred trust of investing the policyholders' money wisely so as to maintain themselves in position to meet the terms of their contracts, long after the contract is made. This is the feature of the business of insurance which sets it apart from all others. It is always based upon a contract whereby the company must maintain itself in a position to carry out its contracts long after they are written and long after the policyholders have paid their money to the company. One of the problems in the regulation of insurance is to make sure that the company charges enough to remain solvent. One of the dangers affecting insurance is the company that offers too much for too little and then finds itself in a position where it cannot carry out its contracts.

90 Cong. Rec. 6564-65 (1944).

Representative Hancock also noted the importance of insurer solvency to the "business of insurance":

> The nature of insurance calls for uniformity and a regulation of competition rather than unrestricted competition. Unrestricted competition does not concern itself with the solvency of a seller, for the ordinary commercial transaction is closed with the sale. On the other hand, the writing of an insurance policy contemplates that the insurer will be able to perform in the future, for the promise of indemnity of the insurer must be performed in the future. Therefore, the solvency of the insurer is of prime importance in insurance. It follows that adequacy of rates is even of more importance than low rates.

90 Cong. Rec. 6526 (1944).

The concerns expressed at the time the McCarran-Ferguson Act was enacted continue to exist in Congress today. Congress has recently examined the findings of the Subcommittee on Oversight and Investigations regarding causes of insurance company failures, focusing on insolvencies of property and casualty insurance companies. <u>See</u> Staff of House Comm. on Energy and Commerce, 101st. Cong., 2d Sess., <u>Failed Promises: Insurance Company Insolvencies</u> (Comm. Print 1990). That report stated, relevantly,:

> An insurer's ability to pay--<u>its solvency</u>--must be subjected to proper regulation on a continuing basis, from the time premium payments are accepted until the time all anticipated insured events have occurred. The policyholder must rely on the competency of the regulatory system, as well as the skill and integrity of the insurer, for protection from insolvency.

<u>Id</u>. at 1. The report stated further that <u>"the Federal government does not presently regulate the activities and solvency of insurance companies. Congress delegated this function exclusively to the states through the McCarran-Ferguson Act of 1945...."</u> <u>Id</u>. at 56 (emphasis added). These comments underscore the fact that state regulation of insurance company insolvencies to protect policyholders is part of the "business of insurance."

C. <u>Learned Treatises:</u>

This Court also has recognized that learned treatises provide valuable instruction regarding the scope of the phrase "business of insurance." <u>Royal Drug</u>, 440 U.S. at 211-212. According to 2 G. Richards, <u>The Law of Insurance</u> §207, <u>Selection and Control of the Risk</u> (5th ed. 1952), "it has been stated that 'the fundamental <u>raison d'etre</u> of insurance is to pay losses.'" In other words, for insurance to exist the loss payment facet cannot be divorced from the risk assumption facet.

The assumption and transfer of risk

factor is addressed in 1 G. Couch, Cyclopedia of Insurance Law §1:3 (2d ed. 1984). According to Couch, "a primary requisite essential to a contract of insurance is the assumption of a risk of loss and the undertaking to indemnify the insureds against such a loss." Therefore, the two parts, assumption of a risk of loss and undertaking to actually indemnify against the loss are inseparable. Without both of these factors, there is no insurance.

Another scholar points out that insurance is:

> (1) a social device in that people and organizations help themselves and each other by exchanging relatively small certain premiums for economic security against potentially large losses, (2) involves a large group of people or organizations who are exposed to risks, (3) allows each person or organization who becomes an insured to transfer risk to the whole group, as evidenced by an insurance contract, (4) involves the systematic accumulation of funds through the statistical prediction of losses and calculations of premiums, and (5) pays for losses in accordance with the terms of an insurance contract.

Athearn and Pritchett, Risk and Insurance 44 (5th ed. 1984) (emphasis added).

Finally:

> [I]nsurers promise to pay if and when the event insured against occurs, but payments from buyers are required in advance. Industrial and mercantile companies sell goods usually delivered to the buyers before payment. If an insurer becomes insolvent and is unable to honor its promises, its customers lose not only the purchase price but also resources relied on to replace damaged property, meet liability claims, provide income during periods of disablity, pay medical expenses, or support surviving dependents. Furthermore, persons winning judgments against insureds may be unable to collect damages, creating a social injustice.

Mehr, Cammack and Rose, Principles of Insurance 715 (8th ed. 1985). See also Greene and Trieschmann, Risk and Insurance 524 (6th ed. 1984) (role of State insurance departments in regulating insurer solvency); Vaughan, Fundamentals of Risk and Insurance 144 (4th ed. 1986) (goals of insurance regulation by State are solvency and equity to insureds); Denenberg, Eilers, Melone and Zelten, Risk and Insurance 618-19 (2d ed. 1974) ("there are some who believe that solvency should be the only objective of insurance regulation"); Rejda, Principles of Insurance 565 (1982) (in which the author points out that state regulation of insurance company solvency includes requirements to maintain solvency, as well as procedures to fulfill the fundamental

goals of insurance once a company becomes insolvent).

As the legislative history of the McCarran-Ferguson Act and learned commentary demonstrate, insurance does not exist unless payment is received by the policyholder for a valid claim. Senator Ferguson's simple and straightforward observation, quoted above, is at the heart of what every person who buys insurance knows - you have bought no protection at all unless at the time a loss occurs a claim payment is made. However intellectually satisfying it may be to argue that the transfer of risk actually occurs at the time the policy is issued and not when a claim is paid, such analysis does not go far in comforting an insured who has suffered a covered loss, but cannot be paid because the insurance company is insolvent. Where the state endeavors to fulfill the promise of insurance by taking over the failed insurer and giving priority to the payment of policyholder claims, it tortures common sense to say this is unrelated to the "business of insurance." To openly make this argument in the hope of augmenting the Treasury of the United States at the expense of individual citizen insureds, when the Government's claim originates from its status as a policyholder or insured, and not as a sovereign, is as callous as it is unpersuasive.

B. THE MEANING OF THE PHRASE "BUSINESS OF INSURANCE" MAY ALSO BE DETERMINED BY REVIEWING FEDERAL ABSTENTION CASES

A significant number of federal courts have addressed the question of what

constitutes the "business of insurance" in the context of resolving motions to abstain from exercising federal jurisdiction in cases involving state insurance liquidation receiverships. As the Sixth Circuit Court of Appeals recognized, the reasoning employed in these cases also is helpful in understanding what the phrase "business of insurance" means. Fabe, 939 F.2d at p. 16. In these abstention cases the federal courts employed the Burford doctrine,"[8] and abstained from exercising federal jurisdiction because they were mindful that state efforts to regulate the winding up of insolvent insurance companies and the payment of claims by policyholders was the business of insurance for purposes of the McCarran-Ferguson Act. Although these cases did not decide the precise issue presented here, they demonstrate why both logic and fairness compel the conclusion that state insurance regulations designed to promote payment of policyholder claims are central to the business of insurance.[9]

8/ Burford v. Sun Oil Co., 319 U.S. 315 (1943).

9/ The government itself refers to cases decided in the context of resolving issues not directly involving the interpretation of the McCarran-Ferguson Act, but which shed light on what the "busines of insurance" is. Brief for Petitioners at 17, citing Pilot Life Ins. Co. v. Dedeaux, 481 U.S. 41 (1987) (interpreting ERISA) and Metropolitan Life Ins. Co. v. Massachusetts, 471 U.S. 724

In Barnhardt Marine Insurance, Inc. v. New England International Surety of America, Inc., 961 F.2d 529 (5th Cir. 1992), the Fifth Circuit recently declared Burford abstention appropriate in a federal action brought against an insurance company which was the subject of ongoing state liquidation proceedings when the federal case was brought. Barnhardt, 961 F.2d 529, 531. The Fifth Circuit Court of Appeals recognized two circumstances in which the application of the Burford doctrine is appropriate: when difficult state law questions of policy are present which are of substantial and far-reaching public concern and when the exercise of federal jurisdiction over the question involved would disrupt state efforts to set a uniform policy on a matter of substantial public concern. Id. The court decided that "Louisiana's insurance laws provide a comprehensive framework for the liquidation of insolvent insurance companies and the resolution of claims against them." Id.; see also Martin Insurance Agency, Inc. v. Prudential Reinsurance Co., 910 F.2d 249 (5th Cir. 1990). Finally, the court declared that by allowing Barnhardt to recover the same assets, litigation of Barnhardt's claims in federal court would usurp Louisiana's control over the liquidation proceeding by allowing Barnhardt to preempt others in the distribution of NEISA's assets. Barnhardt, 961 F.2d at 932.

In Hartford Casualty Insurance Co. v. Borg-Warner Corporation, 913 F.2d 419 (7th Cir. 1990), the Seventh Circuit affirmed the

---

(1985) (also interpreting ERISA).

dismissal of an action against the parent company of an insolvent insurer based on abstention.[10] The Borg-Warner court determined that under the regulatory power given to the states by the McCarran-Ferguson Act over insurance, states have enacted legislation to regulate the rehabilitation and liquidation of insolvent insurers. Borg-Warner, 913 F.2d at 426. Therefore, the court decided the states had a "paramount interest" over anyone else in the regulation of a uniform rehabilitation process.

> With the McCarran-Ferguson Act stating congressional policy that insurance regulation is up to the states, it is difficult to understand how Hartford can maintain that a federal court should entertain a lawsuit where it will have to decide the amount and existence of liability that an insolvent Illinois insurer owes to Hartford.

Borg-Warner, 913 F.2d at 426.

The Seventh Circuit Court of Appeals in Borg-Warner relied heavily on the Tenth Circuit's recent look into the issue of federal court abstention in the context of a

---

10/ The district court also had dismissed the action on ripeness and standing issues, however the Seventh Circuit found the case to be "best understood in terms of abstention." Borg-Warner, 913 F.2d at 424.

state statutory scheme of regulating insolvent insurance companies. Grimes v. Crown Life Insurance Co., 857 F.2d 699 (10th Cir. 1988), cert. denied, 489 U.S. 1096 (1989). The Tenth Circuit Court of Appeals referred to "traditional federal deference provided to state receivership proceedings,"[11] which when considered in conjunction with "complex and comprehensive procedures adopted for the liquidation of insolvent insurers pursuant to the provisions of the McCarran Ferguson Act," allowed the court to decline to exercise jurisdiction over a suit between the state liquidator of an insolvent insurer and a reinsurer. Grimes, 857 F.2d at 703-704.

The Second Circuit has repeatedly affirmed the application of Burford abstention by federal district courts who have declined to exercise jurisdiction over actions involving insolvent insurance companies. See Corcoran v. Ardra Ins. Co., Ltd., 842 F.2d 31 (2nd Cir. 1988); Law Enforcement Ins. Co., Ltd. v. Corcoran, 807 F.2d 38 (2nd Cir. 1986) cert. denied, 481 U.S. 1017 (1987); Levy v. Lewis, 635 F.2d 960 (2nd Cir. 1980). In each of these three cases, the Second Circuit Court of Appeals

11/ For the cases cited by the Tenth Circuit, see Penn General Casualty Co. v. Commonwealth of Pennsylvania ex rel. Schnader, 294 U.S. 189 (1935); Commonwealth of Pennsylvania v. Williams, 294 U.S. 176 (1935); Duggins v. Hunt, 323 F.2d 746 (10th Cir. 1963); Inland Empire Insurance Co. v. Freed, 239 F.2d 289 (10th Cir. 1956).

acknowledged approvingly New York's "complex administrative and judicial system for regulating and liquidating domestic insurance companies." Levy v. Lewis, 635 F.2d at 963, quoted in Corcoran v. Ardra Ins. Co., Ltd., 842 F.2d at 37 and in Law Enforcement Insurance Co., Ltd. v. Corcoran, 807 F.2d at 44. Deferring to state procedures with respect to insurance liquidations pursuant to the McCarran-Ferguson Act was found to be mandated by that Act and, in fact, proper in light of its "express federal policy of noninterference in insurance matters." Levy v. Lewis, 635 F.2d at 963, quoted in Law Enforcement Insurance Co., Ltd. v. Corcoran, 807 F.2d at 44; see also Lac D'Amiante du Quebec, Ltee v. American Home Assurance Co., 864 F.2d 1033 (3rd Cir. 1988) (applying Burford abstention in an action by an asbestos seller against an insurer placed in liquidation).

The holdings reached in these cases illustrate the logic of the conclusion that state regulations governing the payment of policyholder claims through insolvency proceedings does come within the purview of the "business of insurance" as Congress intended that phrase to be interpreted in the McCarran-Ferguson Act. While, admittedly, they did not involve super-priority claims by the government filed with insolvent insurer receiverships, they did involve questions much more closely related to those presented in this case than those which were involved in the trilogy of cases

which produced the three part Pireno test.[12]

C. THE UTILITY OF THE PIRENO TEST AS THE SOLE TEST TO DETERMINE WHAT IS THE BUSINESS OF INSURANCE IS QUESTIONABLE IN CASES INVOLVING THE PRIMARY, REGULATORY FUNCTION OF THE MCCARRAN-FERGUSON ACT

When determining what is meant by the phrase "business of insurance" in the McCarran-Ferguson Act, the fact that the Act was intended to further two distinct goals should not be overlooked. The primary purpose of the McCarran-Ferguson Act was to ensure continued state regulation of the business of insurance. Royal Drug, 440 U.S. 205, 217-218. Congress' goal in passing the statute was "broadly to give support to the existing and future state systems for regulating and taxing the business of insurance." Prudential Insurance Co. v. Benjamin, 328 U.S. 408, 429 (1946) (emphasis supplied). Therefore, in cases involving the primary purpose of the Act, it should be appropriate to broadly interpret the meaning of the phrase "business of insurance" in order to fulfill its primary purpose. In contrast, there was a secondary and more narrow purpose Congress had in mind when the Act was passed, and that was to provide a narrow antitrust exemption to insurance companies to enable them to engage in

12/ Pireno, 458 U.S. 119; Royal Drug, 440 U.S. 205; National Securities Inc., 393 U.S. 453.

cooperative rate making, which otherwise would have violated antitrust laws. Royal Drug, 440 U.S. at 218 n. 18.

The narrow antitrust exemption of the McCarran-Ferguson Act, constitutes only a secondary purpose of the Act. Royal Drug, 440 U.S. at 218 n. 18. Significantly, exemptions from the antitrust laws are to be narrowly construed. Id. at 231. This, too, makes perfect sense. When enacting the McCarran-Ferguson Act, Congress wanted to preserve and encourage the ability of states to regulate insurance without federal interference, but did not want to concomitantly allow insurance companies to take advantage of the antitrust exemption provisions of the Act to engage in anti-competitive activity. Congressional concern that insurance companies, given an inch, might try to take a mile, was not misplaced. All three of the cases decided by this Court in the development of the Pireno test arose from efforts by insurance companies to use the McCarran-Ferguson Act as a shield to protect against charges of antitrust activity.[13] The three part Pireno test properly evolved as a bar to such efforts by insurance companies to circumvent antitrust laws by invoking the protection of

13/ Pireno, 458 U.S. 119 (alleged conspiracy to eliminate price competition among chiropractors); Royal Drug, 440 U.S. 205 (agreements to fix the retail prices of drugs and pharma-ceuticals); National Security, 393 U.S. 453 (merger of two insurance companies).

the McCarran-Ferguson Act, and this Court recognized the fact that this was the context in which the test was being employed. "[T]he only issue before us is whether petitioners' peer review practices are exempt from antitrust scrutiny as part of the 'business of insurance.'" Pireno, 458 U.S. 119, 126 (emphasis supplied). Further, this Court has often repeated that exemptions from antitrust laws are to be narrowly construed, while at the same time recognizing that this secondary purpose of the McCarran-Ferguson Act was quite distinct from its primary purpose of preserving state regulation of the business of insurance. Royal Drug, 440 U.S. at 218 n. 18.

While it may go too far to suggest that the Pireno test for the meaning of the phrase "business of insurance" in the McCarran-Ferguson Act should be limited only to the context of cases interpreting the antitrust exemption of that Act,[14] it also should not be adopted as the exclusive test for defining that phrase, particularly with regard to cases such as this, which involve

---

14/ Indeed, this Court has, on several occasions, looked to the Pireno test to determine what the business of insurance encompassed in contexts other than the interpretation of the McCarran-Ferguson Act. Pilot Life Insurance Co. v. Dedeaux, 481 U.S. 41 (1987) (interpretation of the Employee Retirement Income Security Act of 1974 (ERISA)); Metropolitan Life Insurance Co. v. Massachuetts, 471 U.S. 724 (1985) (interpreting ERISA).

the primary-regulatory purpose of the Act. Instead, this Court should employ a test which gives equal recognition to the unique characteristics of the promise embodied by an insurance policy, the efforts by state insurance regulators to fulfill that promise by adopting measures to effect the priority payment of policyholder claims in insurance company receiverships, and the intent of Congress that states should be able to engage in this type of regulation without federal interference. In cases such as this, where the superpriority claim of the United States to assets of an insolvent insurance company arises from its status as the beneficiary or insured under an insurance policy or surety bond, and not as a sovereign,[15] then the state insurance activity in question does involve the "business of insurance," and the McCarran-Ferguson Act's protections should fully apply.

15/ An example of when a claim by the government would be in its sovereign capacity would be a tax claim filed against an insolvent insurer.

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be affirmed.

Paul W. Grimm*
Mary Alice McNamara
Gina M. Harasti
Niles, Barton & Wilmer
1400 Legg Mason Tower
111 S. Calvert Street
Baltimore, Maryland 21202
(410) 783-6300
*Counsel of Record

6

No. 91-1513

In The

Supreme Court of the United States

October Term, 1992

UNITED STATES DEPARTMENT OF THE TREASURY AND MITCHELL A. LEVINE, ASSISTANT COMMISSIONER,

Petitioners,

v.

GEORGE FABE, SUPERINTENDENT OF INSURANCE, STATE OF OHIO,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Sixth Circuit

BRIEF OF AMICUS CURIAE LEWIS MELAHN IN SUPPORT OF RESPONDENT

THOMAS W. McCARTHY, III
JAMES C. OWEN
McCARTHY, LEONARD, KAEMMERER, OWEN, LADERMAN & LAMKIN
16141 North Outer 40 Drive, Suite 300
Chesterfield, MO 63017

*W. DENNIS CROSS
BRUCE E. BATY
MORRISON & HECKER
2600 Grand Ave.
Kansas City, MO 64108
(816) 691-2600

*Counsel of Record

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

22

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page

CASES

TABLE OF AUTHORITIES – Continued

Page

STATUTES

TABLE OF AUTHORITIES – Continued

TABLE OF AUTHORITIES – Continued

TABLE OF AUTHORITIES – Continued

TABLE OF AUTHORITIES – Continued

TABLE OF AUTHORITIES – Continued

No. 91-1513

In The

Supreme Court of the United States

October Term, 1992

UNITED STATES DEPARTMENT OF THE TREASURY AND MITCHELL A. LEVINE, ASSISTANT COMMISSIONER,

Petitioners,

v.

GEORGE FABE, SUPERINTENDENT OF INSURANCE, STATE OF OHIO,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Sixth Circuit

BRIEF OF AMICUS CURIAE LEWIS MELAHN IN SUPPORT OF RESPONDENT

INTERESTS OF THE AMICUS CURIAE

Lewis Melahn is the Director of the Missouri Department of Insurance and the Receiver for Missouri-chartered Transit Casualty Company. Transit received its charter in 1945. In January 1985, at the direction of the Department, it stopped issuing new policies. It was declared insolvent in November 1985 and placed in receivership on December 3, 1985, by order of the Circuit Court of Cole County, Missouri. With billions of dollars in

liabilities, Transit is one of the largest insurance company receiverships in American history, and has been referred to in a congressional subcommittee report as "the Titanic of Insolvencies."[1]

Although its management was changed by the appointment of the Receiver, the business of Transit is not and has not been significantly different since the institution of the receivership than it was before. Transit operates out of the same offices as before the receivership, and Transit's employees perform most of their pre-receivership functions, including the adjustment and payment of claims under existing policies. One could walk into Transit's offices today and be unable to distinguish it from any other insurance business. The only part of the business of insurance Transit is not engaged in is the issuance of new policies, an activity it ceased months before the appointment of the Receiver.

The Transit receivership is governed by the Missouri Insurance Code, R.S.Mo. chapter 375, which also governs Missouri-chartered insurance companies that are not in receivership. The State of Missouri began regulating the business of insurance in 1845. In 1869 it enacted a comprehensive insurance code, and has since reenacted it in various forms, most recently in 1991. It is "an exclusive code for the insurance business, including the course to be followed in the distribution of the assets of a dissolved company among claimants and others entitled thereto,

[1] Subcommittee on Oversight and Investigations of the House Committee on Energy and Commerce, 101st Cong., 2d Sess., Failed Promises – Insurance Company Insolvencies 31 (Comm. Print 1990) ("Failed Promises").

and *excluding the application of statutes which might seem at first blush to be in conflict with any section of the Insurance Code.*" *O'Malley v. Prudential Casualty & Surety Co.*, 80 S.W.2d 896, 897 (Mo. App. 1935) (emphasis added). The purpose of the Code is "to regulate the insurance business from beginning to end, not alone in the case of the solvency, but in the case of the insolvency of the company as well." *Id.* Petitioners' argument that the administration of insurance company insolvencies is not part of the "business of insurance" subject to the exclusive regulation of the states, therefore, is directly contrary to longstanding Missouri law. It is also contrary to Missouri's understanding of the power of the states to regulate such insolvencies and their traditional role in doing so.

The effect of accepting petitioners' argument would not be limited to preemption of state priority schemes. If the Court holds that state laws governing insurance company receiverships are preempted by the federal priority statute, it will be argued that they are also preempted by other federal statutes of general application, notwithstanding the states' enactment of exclusive codes governing the conduct of such receiverships. Such arguments, moreover, will be made not only by the federal government but by any claimant that believes its interests would be better served in a particular situation by application of some federal statute than by application of the state insurance code.[2]

[2] A recent example is the decision of the Ninth Circuit Court of Appeals in *Bennett v. Liberty Nat'l Fire Ins. Co.*, No. 91-35292, 1992 WL 150985 (9th Cir. July 6, 1992), holding that the Federal Arbitration Act takes precedence over state-prescribed

Missouri, like all other states, has enacted a comprehensive legislative scheme that regulates insurance companies from cradle to grave. Thus the Missouri Insurance Code governed the issuance of Transit's charter to begin operations in 1945. It dictated the amount of capital Transit was required to maintain, regulated the kinds of risk it could insure, and governed its discharge of its claims handling responsibilities. After the Missouri Department of Insurance determined Transit to be insolvent in 1985, the Insurance Code continued to govern its affairs. The Code provided for new management for Transit in the form of a Receiver, required the Receiver to marshal Transit's assets, and directed him in the liquidation and distribution of those assets among various categories of claimants, including claims under policies issued by Transit.

The Receiver has a vital interest in being allowed to continue to conduct the Transit receivership, and to conduct other receiverships to which he may be appointed,

---

procedures for the resolution of disputed claims in insurance company receiverships. Arbitration clauses are common in contracts of insurance and reinsurance, and enforcement of such clauses prior to insolvency usually does not conflict with state insurance codes. It is not hard to imagine cases, however, in which judicial orders compelling the receiver to arbitrate would conflict with the claim resolution procedures established by state law. Insurance codes and arbitration statutes adopted by the states can reconcile the two procedures, defining the circumstances, if any, in which arbitration may be compelled in the context of an insurance company insolvency. If the Federal Arbitration Act is held to preempt state law in this regard, however, the potential for disruption of state regulatory schemes is substantial.

subject only to the requirements of the Missouri Insurance Code. Attempts to impose various provisions of federal statutes on insurance company receiverships could seriously impede their administration and undermine the public policy behind exclusive state regulation of the business of insurance. The Receiver's experience with the Transit receivership places him in a position to provide the Court with a unique perspective on the implications of the parties' arguments to the conduct of insurance company liquidations.

SUMMARY OF ARGUMENT

In their statement of the question presented and thereafter throughout their brief, petitioners treat as established without argument the proposition that, unless state insurance liquidation statutes are laws "regulating the business of insurance" within the meaning of the McCarran-Ferguson Act, they are preempted by the federal priority statute, 31 U.S.C. § 3713(a)(1)(A). By doing so, they avoid discussing the stringent requirements this Court's opinions have imposed on those who argue that federal statutes preempt state law. *See, e.g., Wisconsin Public Intervenor v. Mortier*, 115 L.Ed.2d 532 (1991).[3] They

---

[3] All preemption cases " 'start with the basic assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress.' " *Wisconsin Public Intervenor*, 115 L.Ed.2d at 543 (quoting *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947)). *See also Cipollone v. Liggett Group, Inc.*, 60 U.S.L.W. 4703, 4706 (U.S. June 24, 1992); *Gregory v. Ashcroft*, 115 L.Ed.2d 410, 424 (1991).

also attempt to reduce the preemption question to a narrow issue of statutory construction, and to base that construction on cases that construed McCarran-Ferguson not in the preemption context but as an exemption to the federal antitrust laws. Thus they argue that state law should be given extraordinarily narrow scope in a field in which Congress has expressly left state law supreme.

Long before the McCarran-Ferguson Act affirmed that the business of insurance was subject to exclusive state regulation, the states exercised unquestioned exclusive authority in that area. Although the federal priority statute has been on the books for two hundred years, this Court has never held, and until recently no court has held, that it preempted state laws governing insurance company insolvencies.

Regulation of insurance company insolvencies has traditionally and uniformly been regarded as an integral part of the states' regulation of the business of insurance. It is impossible to separate regulation of the obligations contained in insurance policies from regulation of the insurers' performance of those obligations. Receivers must perform those obligations in the case of insolvency; and in doing so they, like the companies in whose shoes they stand, are subject to the exclusive regulation of state law. Petitioners' argument to the contrary mistakenly relies on cases in which this Court has construed the "business of insurance" language, not as an expression of congressional intent regarding preemption, but in the very different context of a claimed exemption from the federal antitrust laws. It also ignores this Court's definition of the "business of insurance", adopted even in the

antitrust exemption context, which includes the "enforcement" of insurance contracts as well as the issuance of policies.

Not only is there no clear expression of an intent on the part of Congress to preempt state laws governing insurance company receiverships, but McCarran-Ferguson is a clear expression of contrary intent. That statute, enacted in 1945 in response to this Court's ruling the previous year that the business of insurance was subject to federal regulation under the commerce clause, reaffirmed the states' exclusive role in the area of insurance company regulation. The statute specifically provides that "[n]o Act of Congress shall be construed to invalidate, impair or supersede any law enacted by any state for the purpose of regulating the business of insurance." Because state insurance codes are undeniably laws enacted for that regulatory purpose, McCarran-Ferguson refutes in the clearest possible terms petitioners' argument that the federal priority statute impairs or supersedes those codes.

ARGUMENT

I. REGULATION OF INSURANCE COMPANY INSOLVENCIES IS A TRADITIONAL AND EXCLUSIVE FUNCTION OF THE STATES

Enactment of the McCarran-Ferguson Act in 1945 did not represent a departure in the allocation of functions between state and federal governments in the area of insurance regulation. On the contrary, it recognized and sought to preserve the long-standing primacy of the

states in that area. State insurance regulation, moreover, was clearly understood to include regulation of insurance company insolvencies. Missouri's comprehensive insurance code, for example, was originally enacted in 1869, and included from the beginning a statutory framework for the liquidation of insolvent insurers. A federal court observed in 1938 that under the Missouri Insurance Code "[t]he object to be attained by the liquidation of an insolvent insurance company is the prompt, fair and equitable closing of an estate for the benefit of all creditors." *Pensinger v. Pacific States Life Ins. Co.*, 25 F. Supp. 295, 297 (E.D.Mo. 1938).

Winding up the affairs of insolvent insurers has long been recognized as an integral part of Missouri's insurance regulation. As the Missouri Supreme Court wrote in 1932, "[t]he original Code and amendments thereto indicate an intention to regulate the business of insurance from beginning to end, thereby protecting individual and public interests." *State v. Hall*, 52 S.W.2d 174, 177 (Mo. 1932). The Court also noted that Missouri's power "to authorize, supervise, regulate, *and liquidate* insurance companies rests on the interests of the public in the insurance business." *Id.* (emphasis added). *See also O'Malley v. Prudential Casualty & Surety Co.*, 230 Mo.App. 935, 80 S.W.2d 896, 897 (1935) (Missouri provides "an exclusive code for the insurance business including the course to be followed in the distribution of the assets of a dissolved company . . . and excluding the application of statutes which might seem . . . to be in conflict"); *Medallion Ins. Co. v. Wartenbee*, 568 S.W.2d 599, 601 (Mo.App. 1978) (same); *State ex rel. ISC Financial Corp. v. Kinder*, 684 S.W.2d 910, 913 (Mo.App. 1985) (Missouri statute "sets up a self-contained and exclusive scheme" for liquidation of insolvent insurance companies); *Melahn v. Continental Security Life Insurance Company*, 793 S.W.2d 425 (Mo.App. 1990) (Missouri Insurance Code is an exclusive code for the supervision of insurance companies).

Petitioners cite *United States v. Knott*, 298 U.S. 544 (1936), for the proposition that state insurance liquidation schemes have always been preempted by the federal priority statute. Pet. Br. 24. Contrary to petitioners' argument, however, that case did not involve preemption. The receivership in *Knott* was being conducted pursuant to New Jersey law, and neither the federal government nor any other party challenged the New Jersey receiver's assignment of priorities. The only question was whether certain assets the insolvent company had deposited with the Florida secretary of state as a condition of doing business in the state could be used by Florida for distribution to its own citizens or had remained property of the company available for distribution by the receiver. The Court held that the Florida statute, as previously construed by the Florida Supreme Court, merely created a general inchoate lien on the deposited assets, and that they therefore remained the property of the company and became part of the receivership estate. 298 U.S. at 552.

The subsequent history of the issue decided in *Knott* contradicts rather than supports petitioners' argument. In 1939 the National Association of Insurance Commissioners promulgated the Uniform Insurers Liquidation Act ("UILA"), and most states, including New Jersey, Florida and Missouri, have since adopted it. Section 7 of the UILA provides that assets deposited by insurers as a condition of doing business in a state, like those involved

in *Knott*, may be retained by the state for distribution in accordance with that state's law and are not considered part of the insolvent company's estate available for distribution by the receiver. If *Knott* had been a preemption case, the states' widespread adoption of that UILA provision, which reverses the result of *Knott*, would have been ineffective. It has never been held, however, and it appears never even to have been argued, that the federal priority statute overrides that provision of the UILA.

The Missouri Insurance Code since 1879 has included a priority scheme for the distribution of liquidated assets. Under that priority scheme, claims of the federal government are given the same priority as claims of the state government and local governments within the state. For over one hundred years there has been no suggestion that Missouri's priority scheme might be subject to the federal superpriority statute.

All fifty states have statutes comprehensively regulating the liquidation of insolvent insurance companies.[4] As one treatise noted:

[4] Ala. Code § 27-32-1, et seq.; Alaska Stat. § 21.78.010, et seq.; Ariz. Rev. Stat. Ann. § 20-611, et seq.; Ark. Code Ann. § 23-68-101, et seq.; Cal. Insurance Code § 980, et seq.; Colo. Rev. Stat. § 10-3-501, et seq.; Conn. Gen. Stat. Ann. § 38a-903, et seq.; Del. Code Ann tit. 18 § 5901, et seq.; Fla. Stat. ch. 631.001, et seq.; Ga. Code § 33-37-1, et seq.; Haw. Rev. Stat. Ann. § 431:15-101, et seq.; Idaho Code § 41-3301, et seq.; Ill. Ann. Stat. Ch. 73 para. 799, et seq.; Ind. Code Ann. § 27-9-1-1, et seq.; Iowa Code Ann. § 507C.1, et seq.; Kan. Stat. Ann. § 40-3601, et seq.; Ky. Rev. Stat. Ann. § 304.33-010, et seq.; La. Rev. Stat. Ann. § 22:731, et seq.; Me. Rev. Stat. Ann. tit. 24-A, § 4351, et seq.; Md. Code Ann., Insurance § 48A-132, et seq.; Mass. Gen. Laws Ann. ch. 175, § 180A, et seq.; Mich. Comp. Laws Ann. § 500.8101, et seq.; Minn. Stat. Ann. § 60B.01, et seq.; Miss. Code Ann. § 83-24-1, et seq.; Mo. Ann. Stat. § 375.1150, et seq.; Mont. Code Ann. § 33-2-1301, et seq.; Neb. Rev. Stat. § 44-4801, et seq.; Nev. Rev. Stat. § 696B.010, et seq.; N.H. Rev. Stat. Ann. § 402-C:1, et seq.; N.J. Rev. Stat. § 17:30C-1, et seq.; N.M. Stat. Ann. § 59A-41-1, et seq; N.Y. Insurance Law § 7401, et seq.; N.C. Gen. Stat. § 58-30-1, et seq.; N.D. Cent. Code § 26.1-06.1-01, et seq.; Ohio Rev. Code Ann. § 3903.01, et seq.; Okla. Stat. tit. 36 § 1901, et seq.; Or. Rev. Stat. § 734.010, et seq.; Pa. Stat. Ann. tit. 40 § 211, et seq.; R.I. Gen. Laws § 27-14-1, et seq.; S.C. Code Ann. § 38-27-10, et seq.; S.D. Codified Laws Ann. § 58-29B-1, et seq.; Tenn. Code Ann. § 56-9-101, et seq.; Tex. Insurance Code Ann. § 21.25, et seq.; Utah Code Ann. § 31A-27-101, et seq.; Vt. Stat. Ann. tit. 8 § 7031, et seq.; Va. Code Ann. § 38.2-1500, et seq.; Wash. Rev. Code Ann. § 48.31.010, et seq.; W. Va. Code § 33-10-1, et seq.; Wis. Stat. § 645.01, et seq.; Wyo. Stat. § 26-28-101, et seq.

> "The state has an important and vital interest in the liquidation of an insolvent insurance company, and the contract of a policy holder of such a company is subject to the reasonable exercise of the state's police power in these respects. The only restriction on the exercise of the power is that the state's action shall be reasonably related to the public interest and shall not be arbitrary or improperly discriminatory."

2A Couch on Insurance 2d § 22.52.

Federal courts have traditionally respected the exclusive role of the states in the regulation of insurance company insolvencies. When insurance companies in Wisconsin filed suit in federal court challenging the constitutionality of state statutes governing the liquidation of insolvent insurers, the court abstained, stating:

> "the very exercise of federal jurisdiction will interrupt the state's efforts to effect its policy respecting the liquidation and rehabilitation of

> Wisconsin insurance companies and the concomitant protection of policyholders. . . . It is a matter of substantial state concern that the process of liquidating an insurance company be carried out in an orderly and efficient manner, so as to protect the interests of the company's owners, policyholders, and creditors, as well as the public."

Metropolitan Life Ins. Co. v. Board of Directors, 572 F. Supp. 460, 473 (W.D. Wisc. 1983). *See also Levy v. Lewis*, 635 F.2d 960 (2d Cir. 1980) (abstention would prevent duplication of effort and enable state to consolidate all claims against insolvent insurer); *Corcoran v. Ardra Ins. Co., Ltd.*, 657 F. Supp. 1223 (S.D.N.Y. 1987) (existence of a comprehensive state administrative framework is an important factor supporting federal abstention). As the court in *Metropolitan Life* further noted, "the orderly administration of justice and the prevention of unseemly conflicts between courts require . . . defer[ence] to the state courts . . . " 572 F. Supp. at 472.

Similarly, in *O'Neil v. Welch*, 245 F. 261 (3d Cir. 1917), the court recognized Pennsylvania's interest in regulating the business of insurance. The court noted the state's comprehensive administrative scheme involving the examination, regulation and dissolution of insurance companies.[5] It rejected federal intervention as

[5] "In assuming this function the State has defined rights conferred upon insurance companies and rights reserved to itself, imposed duties and prescribed remedies. In conferring upon insurance companies incorporated under its laws the right to solicit business from the public, it imposed upon them the

counterproductive, infringing on the state's exclusive authority in this area: "Thus the policy of the State would be thwarted and its administration overthrown." *Id.* at 268. *See also Superintendent of Ins. v. Bankers Life & Cas. Co.*, 401 F. Supp. 640 (S.D.N.Y. 1975) (management and liquidation of insolvent insurers is an exclusive state interest).

A common theme found in the authorities upholding the states' exclusive role in regulating insurance company insolvencies is emphasis on the states' interest in protecting policyholders and the public. In serving that interest, every state has included in its insurance code provisions regulating insurance company insolvencies. More than 40 states have specific provisions that assign priorities for policyholders and the federal government, among other claimants.[6] Some states, like Florida and New Jersey, give

duty to be solvent and to conduct their business honestly, and reserved to itself the right to inquire both as to their solvency and business conduct, and when necessary to stay their business and end their existence." *O'Neil*, 245 F. at 267.

[6] Alaska Stat. § 21.78.260; Ariz. Rev. Stat. Ann. § 20-629; Ark. Code Ann. § 23-68-126; Cal. Insurance Code § 1033; Colo. Rev. Stat. § 10-3-507; Conn. Gen. Stat. Ann. § 38a- 944; Fla. Stat. ch. 631.271; Ga. Code § 33-37-41; Haw. Rev. Stat. Ann. § 431:15-332; Idaho Code § 41-3342; Ill. Ann. Stat. Ch. 73 para. 817; Ind. Code Ann. § 27-9-3-40; Iowa Code Ann. § 507C.42; Kan. Stat. Ann. § 40-3601(a)(2); Ky. Rev. Stat. Ann. § 304.33-430; Me. Rev. Stat. Ann. tit. 24-A, § 4379(5); Mass. Gen. Laws Ann. ch. 175, § 180F(3); Mich. Comp. Laws Ann. § 500.8142(e); Minn. Stat. Ann. § 60B.44; Miss. Code Ann. § 83-24-83(3) & (5); Mo. Ann. Stat. § 375.1218; Mont. Code Ann. § 33-2-1371(5); Neb. Rev. Stat. § 44-4842(3); Nev. Rev. Stat. § 696B.420; N.H. Rev. Stat. Ann. § 402-C:44; N.J. Rev. Stat. § 17:30C-26(c); N.M. Stat. Ann.

the federal government priority over policyholders, while others, like Connecticut and Arizona, prefer policyholders.[7] None give the federal government the absolute priority claimed by petitioners in this case. Thus the states have recognized and assumed the responsibility of regulating insurance company receiverships as an integral and inseparable part of the business of insurance, and most of them have viewed the assignment of priorities as an integral part of that regulation.[8]

---

§ 59A-41-49(E); N.D. Cent. Code § 26.1-06.1(3)(5); Ohio Rev. Code Ann. § 3903.42(E); Or. Rev. Stat. § 734.360; Pa. Stat. Ann. tit. 40 § 221.44; R.I. Gen. Laws § 27-14-22(C); S.C. Code Ann. § 38-27-610(5); S.D. Codified Laws Ann. § 58-29B-124(5); Tenn. Code Ann. § 56-9-330(3); Utah Code Ann. § 31A-27-335(5); Vt. Stat. Ann. tit. 8 § 7081(3) & (5); Va. Code Ann. § 38.2-1509; Wash. Rev. Code Ann. § 48.31.280(c); W. Va. Code § 33-10-19a(6)(c)(e); Wyo. Stat. § 26-28-125.

[7] The Transit receivership is governed by the priority scheme that was in effect at the time Transit was declared insolvent. R.S.Mo. § 375.700. That scheme assigns second priority (behind administrative expenses) to claims by the federal government, the state of Missouri and local governments within the state. Policyholders are assigned third priority. In 1991, Missouri adopted the priority scheme of the NAIC Insurers' Supervision, Rehabilitation, and Liquidation Model Act, under which policyholder claims and some governmental claims share second priority and other governmental claims are assigned fifth priority. R.S.Mo. § 375.1218.

[8] Kimball, History and Development of the Laws of State Insurer Insolvency Proceedings: An Overview, Law and Practice of Insurance Company Insolvency 1986 ABA Sec. Tort & Ins. Prac. 10. "Congress decided to leave insurance regulation basically to the states, and implemented its decision by the McCarran-Ferguson Act. It was natural, therefore, that the states should continue as they did to develop the law of insurance company liquidation." *Id.* at 17.

II. THE BUSINESS OF INSURANCE INCLUDES THE LIQUIDATION OF INSOLVENT INSURANCE COMPANIES

The widespread adoption by the states of insurance codes that include regulation of insurance company insolvencies is not, as petitioners' argument implies, a case of overreaching. Rather it reflects the states' recognition that regulation of the performance of insurance contracts cannot be sensibly separated from regulation of their content. If the state is to regulate the obligations insurance companies incur when they enter into insurance contracts, it must also be allowed to regulate the performance of those obligations, whether that performance takes place before or after insolvency.

Only by the most extraordinarily narrow interpretation of the term could it be said that the business of insurance includes only the issuance of policies and not the payment of claims. Such a narrow interpretation was in fact adopted by this Court in *Paul v. Virginia*, 75 U.S. (8 Wall.) 168 (1868), when it held that the business of insurance was a purely local activity and therefore not subject to federal regulation as interstate commerce. In *United States v. South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944), however, the Court overruled *Paul*, holding that the business of insurance includes not only the issuance of the policy but also "negotiations and events prior to execution of the contracts and *the innumerable transactions necessary to performance of the contracts*". *Id.* at 537 (emphasis added).

After *South-Eastern Underwriters*, Congress enacted the McCarran-Ferguson Act, leaving the business of

insurance to the exclusive regulation of the states. Construing that statute in *SEC v. National Securities, Inc.*, 393 U.S. 453 (1969), this Court noted that the "business of insurance" was a narrower concept than the business of insurance companies, and held that McCarran-Ferguson exempts only the former from federal regulation. In defining the "business of insurance" for that purpose, it adhered to the view expressed in *South-Eastern Underwriters* that the "core" of that business included not only the issuance of policies but also their "reliability, interpretation *and enforcement*". *Id.* at 460 (emphasis added). The Court quoted that definition with approval in both *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205, 215-16 (1979), and *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, 128 (1982).

Petitioners' argument that the states' exclusive role in regulating the "business of insurance" is limited to the time of the policies' issuance (Pet. Br. 18-19) is thus contrary not only to the logic of the public policy underlying state regulation of insurance but also to the language of this Court's opinions. The state regulation at issue in this case is not of insurance company acquisitions and mergers, as in *National Securities*, nor of agreements ancillary to the discharge of the insurance company's obligations, as in *Royal Drug* (agreements with pharmaceutical providers) and *Pireno* (agreements with peer review organizations participating in the review and adjustment of claims). The regulation in this case is of the performance of the insurance contract itself, an activity that is the essence of the business of insurance. Insurance would still be insurance without either provider agreements or

peer review. The insurance contract would be meaningless, however, without the insurer's performance of its obligation to pay valid claims. *See Pireno*, 458 U.S. at 137 (Rehnquist, J., dissenting) ("Few insurance company matters could be of greater importance to policyholders than whether their claims will be paid").

Petitioners argue (Pet. Br. 14-15) that receivers are not in the business of insurance because they do not issue policies. It does not follow, however, from the fact that receivers do not engage in *all* aspects of the business of insurance that they do not engage in the business of insurance at all. Even insurance companies that are not in receivership sometimes stop issuing policies; Transit itself stopped issuing policies almost a year before it was declared insolvent. Such companies do not thereby stop engaging in the business of insurance and they do not stop being subject to state insurance regulation.[9]

Petitioners do not deny that a receiver steps into the shoes of the insolvent company, assuming all the company's rights and obligations. 2A Couch on Insurance 2d § 22:45; UILA §§ 2(2), 3(2); *see Relfe v. Rundle*, 103 U.S. 222, 224 (1880) (the Missouri Insurance Code giving the receiver control of the insolvent company's property "was, in legal effect, part of the charter of the corporation"). Among the rights and obligations assumed by the receiver of an insurance company are those arising directly from its contracts of insurance, including the

---

[9] The Missouri Insurance Code expressly provides that "[t]he liquidation of any insurer shall be considered to be the business of insurance for purposes of application of any law of this state." R.S.Mo. § 375.1176.1.

right to receive unpaid premiums and the obligation to pay covered claims. Under any reasonable construction of the term, the receiver is engaged in the business of insurance when he enforces those rights and performs those obligations.[10]

Petitioners miss the point entirely when they suggest (Pet. Br. 7-8) that receivers are not in the business of insurance because the risk of the insurer's insolvency is not part of the risk transferred by the insurance policy. The business of insurance that is regulated by the insolvency provisions of state insurance codes is not insurance against insolvency; it is the insurance afforded by the insolvent company's policies. Those policies, issued before insolvency, transferred risk from the policyholders to the company, and the state insurance codes regulate the payment (both before and after insolvency) of losses covered by those policies. In doing so, they regulate the business of insurance.[11]

Petitioners make a similar mistake when they point out (Pet. Br. 18) that the Ohio statute (as distinct from the

[10] Petitioners concede that receivers "may continue to engage in aspects of the business of insurance during the liquidation" (Pet. Br. 15 n. 5) but do not concede the logical corollary: that when they do so (as when they adjust, prioritize and pay policyholders' claims) McCarran-Ferguson leaves them answerable only to state law.

[11] All of Transit's reinsurance treaties, which represent a substantial portion of the assets available to the Receiver, include clauses contemplating the continuation of the business of insurance by the receiver in the event of Transit's insolvency.

insurance policies it regulates) does not result in any transfer of risk. The question, of course, is not whether the state law *is* the business of insurance but whether it *regulates* that business. The insolvent company was engaged in the business of insurance before insolvency; the receiver is engaged in that business after insolvency to the extent it is necessary to wind up the affairs of the company; and the state law regulates both the company and the receiver in their conduct of that business. McCarran-Ferguson provides that that regulation is exclusive and may not be "invalidate[d], impair[ed] or supersede[d]" by any act of Congress.

Petitioners' attempt to draw a dispositive distinction between regulation of the obligations contained in insurance policies and regulation of the performance of those obligations, and their further attempt to draw a distinction between the performance of those obligations by solvent and insolvent companies, rest on no principled foundation and ignore the realities of the insurance business and insurance company liquidations. States could not effectively regulate the business of insurance if their exclusive power to do so did not encompass liquidations as well as other aspects of the business.

III. THE McCARRAN-FERGUSON ACT CONFIRMED THE STATES' EXCLUSIVE ROLE IN THE REGULATION OF THE BUSINESS OF INSURANCE

By declaring the business of insurance to be interstate commerce, *South-Eastern Underwriters* made possible

the application to the insurance industry of federal legislation based on the commerce clause.[12] Congress acted swiftly, however, not only to disavow any intent to take over the states' traditional role in insurance regulation, but also to provide that no existing federal statute should interfere with the states' exclusive role in that regard. Thus the McCarran-Ferguson Act provided not only that "the business of insurance . . . shall be subject to the laws of the several states which relate to the regulation . . . of such business" but also that "[n]o Act of Congress shall be construed to invalidate, impair or supersede any law enacted by any State for the purpose of regulating the business of insurance." 15 U.S.C. § 1012(b).

There can be no question that the insurance codes of Ohio, Missouri and other states are laws "enacted . . . for the purpose of regulating the business of insurance." The plain language of McCarran-Ferguson, therefore, refutes petitioners' argument that the federal priority statute, or any other federal statute, should be held to "invalidate, impair or supersede" any part of those codes. It would be difficult, indeed, to imagine language more clearly designed to express Congress's intent that state laws *not* be preempted.

Even if there were no McCarran-Ferguson Act, of course, it would not follow that Congress intended to preempt state insurance codes when it enacted the federal

[12] Because the federal priority statute was not enacted pursuant to the commerce power, *South-Eastern Underwriters* did not affect federal power in that area.

priority statute. Petitioners would still bear a heavy burden of showing a clear statement of such intent by Congress.[13] McCarran-Ferguson simply makes it unnecessary to speculate about the intent of a Congress that sat two hundred years ago, when it is most likely that it had no intent one way or the other regarding state insurance codes that at that time were not even in existence.

There is no issue in this case regarding the extent to which McCarran-Ferguson may provide an exemption from the federal antitrust laws. There is no occasion, therefore, to invoke the well-settled rule that such exemptions are narrowly construed, a rule that was the starting point for this Court's analysis in both *Royal Drug*, 440 U.S. at 231, and *Pireno*, 458 U.S. at 126. Application of that rule in this case, moreover, would in effect reverse the presumption *against* federal preemption of state law that is a fundamental part of this country's constitutional doctrine.

It would be particularly inappropriate to adopt a narrow construction of McCarran-Ferguson's language when the effect of that construction would be not to give full scope to a federal regulatory scheme (as in *Royal Drug* and *Pireno*) but to create federally mandated exemptions from regulatory schemes adopted by the states. The preemption urged by petitioners in this case is not preemption by a federal regulatory scheme, because the federal government has never attempted to regulate insurance company insolvencies or any other aspect of the insurance business. Instead, petitioners argue that a federal statute of

[13] See note 3, *supra*.

general application should be applied to the specific case of insurance company receiverships in such a way as to override a particular provision of the state's insurance code. That kind of preemption would not mean the replacement of state regulatory schemes by a federal one; it would mean the creation of piecemeal exceptions, mandated by federal statutes enacted with no consideration of their impact on the business of insurance, to otherwise comprehensive and self-contained systems of regulation in virtually every state. Such exceptions would undermine the integrity of state regulatory systems in an area where not only is there no substitute system of federal regulation but where a federal statute exists expressly leaving regulation to the states. It is very unlikely, especially in light of the express provisions of McCarran-Ferguson, that Congress intended such a result.[14]

The relevance of the McCarran-Ferguson Act to this case, therefore, is not that it provides an exemption from a

---

[14] Congress is currently reviewing legislation that would authorize limited federal regulation in the area of insurance company insolvency. H.R. 4900, 102d Cong., 2d Sess. (1992). The legislation, entitled the "Federal Insurance Insolvency Act of 1992," was introduced in this Congress by Rep. John Dingell (D-Mich.), chairman of the Subcommittee on Oversight and Investigations of the House Committee on Energy and Commerce. A report by that subcommittee in the last Congress noted that "[u]nder the present regulatory framework, state insurance departments are responsible for regulating insurance company solvency, and administering the liquidation of insolvent companies." Failed Promises 72. Thus the responsible congressional oversight committee agrees with the states that the regulation of insurance company insolvencies is part of the "business of insurance" regulated exclusively by the states. Until Congress acts to amend the law, it should remain that way.

federal regulatory scheme but rather that it expresses Congress's intent on the underlying preemption question. So viewed, there can be little doubt that it makes the usual heavy presumption against federal preemption of state law virtually conclusive in the area of insurance regulation. Far from having clearly stated an intent to preempt state law in the area of insurance regulation, Congress by enacting McCarran-Ferguson clearly stated the opposite intent: to leave state law supreme. Petitioners' position, which is directly contrary to that clearly stated intent, should be rejected.

CONCLUSION

For the reasons stated herein, the judgment of the United States Court of Appeals for the Sixth Circuit should be affirmed.

Respectfully submitted,

THOMAS W. MCCARTHY, III
JAMES C. OWEN
MCCARTHY, LEONARD,
KAEMMERER, OWEN,
LADERMAN & LAMKIN
16141 North Outer
40 Drive, Suite 300
Chesterfield, MO 63017

*W. DENNIS CROSS
BRUCE E. BATY
MORRISON & HECKER
2600 Grand Ave.
Kansas City, MO 64108
(816) 691-2600

*Counsel of Record

(8)

No. 91-1513

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

UNITED STATES DEPARTMENT OF THE TREASURY AND
MITCHELL A. LEVINE,
ASSISTANT COMMISSIONER, PETITIONERS

v.

GEORGE FABE, SUPERINTENDENT OF INSURANCE,
STATE OF OHIO

*On Writ of Certiorari to the
United States Court of Appeals
For the Sixth Circuit*

**MOTION FOR LEAVE TO FILE
BRIEF FOR THE AMICUS CURIAE
BUREAU OF INSURANCE, COMMONWEALTH OF VIRGINIA
DEPARTMENT OF INSURANCE, STATE OF NORTH DAKOTA**

PATRICK H. CANTILO
HAROLD B. GOLD
RANDOLPH N. WISENER
JILL C. ADLER

RUBINSTEIN & PERRY, L.L.P.
2000 LINCOLN PLAZA
500 NORTH AKARD STREET
DALLAS, TEXAS 75201
(214) 740-4600

3

No. 91-1513

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

UNITED STATES DEPARTMENT OF THE TREASURY AND
MITCHELL A. LEVINE,
ASSISTANT COMMISSIONER, PETITIONERS

v.

GEORGE FABE, SUPERINTENDENT OF INSURANCE,
STATE OF OHIO

*On Writ of Certiorari to the
United States Court of Appeals
For the Sixth Circuit*

**MOTION FOR LEAVE TO FILE
BRIEF FOR THE AMICUS CURIAE
BUREAU OF INSURANCE, COMMONWEALTH OF VIRGINIA
DEPARTMENT OF INSURANCE, STATE OF NORTH DAKOTA**

PATRICK H. CANTILO
HAROLD B. GOLD
RANDOLPH N. WISENER
JILL C. ADLER

RUBINSTEIN & PERRY, L.L.P.
2000 LINCOLN PLAZA
500 NORTH AKARD STREET
DALLAS, TEXAS 75201
(214) 740-4600

TO THE HONORABLE UNITED STATES SUPREME COURT:

The Bureau of Insurance of the Commonwealth of Virginia and the Department of Insurance of the State of North Dakota, hereby submit their Motion for Leave to submit an *Amicus Curiae* brief in support of the position of the Respondent. Both the Petitioner and Respondent have consented to this filing of the *Amicus Curiae* brief, as shown in the letters of consent which have been lodged with the Court.

THEREFORE, movants request that their Motion of Leave to file a brief in the above captioned matter as *Amicus Curiae* be granted.

Respectfully submitted,

RUBINSTEIN & PERRY, L.L.P.

By: ______________________

Harold B. Gold

2000 Lincoln Plaza
500 North Akard Street
Dallas, Texas 75201
(214) 740-4600
(214) 740-4646 [Fax]

CERTIFICATE OF SERVICE

One copy of the foregoing Motion for Leave to file *Amicus Curiae* brief was served on Kenneth Starr and James C. Rishel, each by certified mail, deposited with the United States Postal Service on September 8, 1992.

By: ______________________

Harold B. Gold

Supreme Court, U.S.
FILED
SEP 8 1992
OFFICE OF THE CLERK

9

No. 91-1513

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

UNITED STATES DEPARTMENT OF THE TREASURY AND
MITCHELL A. LEVINE,
ASSISTANT COMMISSIONER, PETITIONERS

v.

GEORGE FABE, SUPERINTENDENT OF INSURANCE,
STATE OF OHIO

On Writ of Certiorari to the
United States Court of Appeals
For the Sixth Circuit

BRIEF FOR THE AMICUS CURIAE
BUREAU OF INSURANCE, COMMONWEALTH OF VIRGINIA
DEPARTMENT OF INSURANCE, STATE OF NORTH DAKOTA

PATRICK H. CANTILO
HAROLD B. GOLD
RANDOLPH N. WISENER
JILL C. ADLER

RUBINSTEIN & PERRY, L.L.P.
2000 LINCOLN PLAZA
500 NORTH AKARD STREET
DALLAS, TEXAS 75201
(214) 740-4600

35

STATEMENT OF STANDING

The Bureau of Insurance of the State Corporation Commission of The Commonwealth of Virginia and the Department of Insurance of the State of North Dakota, as *amicus curiae*, have obtained the consent of both the Petitioner and the Respondent to submit this brief. The letters of consent have been lodged with the Clerk of the Court.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES

INTRODUCTION

While it may be framed in a variety of different ways, the issue presented to this Honorable Court is fundamentally the following: in this age of larger and more frequent insurer insolvencies, to what extent will state regulators be able to rely upon the protection afforded to them by Congress in the *McCarran-Ferguson Act* in their quest to fully protect the insurance buying public from the ravages of the industry's mismanagement and misfortune? In 1945 Congress determined that, with the exception of the antitrust laws, the states' exercise of their police power in assuring that insurance consumers would be able to realize the contractual benefits for which they had paid should remain unfettered by the unintended application of the plethora of federal laws governing interstate commerce. This case presents the Court the opportunity to resolve unequivocally whether the intent of Congress to permit the several states to protect their citizenry in the insurance world may be frustrated by hyper-technical erosions on the application of this all-important statute.

Insurance plays a significant role in the smooth operation of commerce, industry and the everyday lives of Americans. There is little doubt that often it is the means by which businesses can continue to exist, and people can plan for their future. With the growing prominence and reliance on insurance, there has been a proportionate rise in the problems experienced with insurance companies. It has been the traditional role of the states to regulate the affairs of the insurance industry in order to protect the interests of the policyholders who rely on the insurance company for so much. This role should not be undermined by the application of the federal priority statute as advocated by the Petitioner.

Summary of Argument

1. As is reflected in 15 U.S.C. §§ 1011 and 1012, Congress intended that the regulation of the insurance industry be left in the hands of the states. Under Section 1011, the business of insurance and every person engaged in it are subject to state regulation and, under Section 1012, no federal law (other than anti-trust laws) shall take precedence over such state regulation unless it is specifically directed at insurance. The scope of state regulation is over the entire industry, not merely the insurance policy.

2. The liquidation of an insurance company, including the scheme by which its assets are distributed, is part of the state's regulation of insurance. Accordingly, the Ohio liquidation statute, including that portion dealing with the order in which claimants receive distributions, and not the federal priority statute, which is not specifically directed toward insurance, governs the relative rank of creditors in the allocation of the insolvent insurer's assets. Application of this Court's test as announced in *Royal Drug* and in *Pireno* to reach a contrary result raises a specter of unnecessary clash between the will of Congress as manifested in the Act and this Court's well reasoned application of that statute's expressed retention of federal anti-trust jurisdiction over insurers.

3. Because of its unique nature, insurer liquidation is, and should be, exempted from the *Federal Priority Statute*, as are bankruptcy proceedings. But for the exception the Bankruptcy Code makes for them, insurers would be debtors and outside the scope of the *Federal Priority Statute*. Congress has left the liquidation of insurance companies to the states, not for the reason that it desires that the federal government receive priority payments, but because the states are in the best position to administer the estates in the interest of all claimants.

4. The state scheme of regulation for insurance companies, while designed to protect the interest of policyholders, also serves the interests of other claimants to the estates, and does so in an orderly fashion. In a properly administered estate, there is no rational basis for giving precedence to the federal government. Priority, if any, is properly placed according to the comprehensive state regulatory scheme, so long as it does not discriminate against interests similarly situated. Since that is the case with the Ohio statute, the ruling of the Court of Appeals for the Sixth Circuit is well reasoned, is consonant with the intent of Congress and the applicable decisions of this Honorable Court, and should be affirmed.

Argument

A. The *McCarran-Ferguson Act* Gives Broad Power To The States To Regulate The "Business of Insurance"

The *McCarran-Ferguson Act* was passed in response to the ruling in *United States v. South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944). *South-Eastern Underwriters*, for the first time, allowed partial federal regulation of insurance companies. Before *South-Eastern Underwriters*, insurance transactions were not considered to be part of interstate commerce and, thus, were beyond federal regulation. *Paul v. Virginia*, 75 U.S. (8 Wall.) 168 (1868). While *Paul* focused on the broad question of the right of the states or the federal government to regulate insurance, *South-Eastern Underwriters* had a more narrow focus, addressing the application of federal antitrust laws to the insurance industry. Fearful that the *South-Eastern Underwriters* decision would eliminate the regulatory power states had over the insurance industry, Congress passed the *McCarran-Ferguson Act*, 15 U.S.C.A. §§ 1011-15 (West 1976) (the *Act*).

The House of Representatives, after oral argument in *South-Eastern Underwriters*, but before this Court announced its opinion, passed a bill exempting the insurance business from federal antitrust laws. *See* 90 Cong. Rec. 6565 (1944). This first bill was, however, killed in the Senate. *See id.* at 8054. Nevertheless, early the next year, as a reaction to the threat of increasing federal regulation over the insurance business, and to resolve the

crisis created among the several states in reference to the regulation and taxation of the insurance industry, Congress again turned its attention to the issue of regulation of the insurance industry and the Act was the result. *See* Act of March 6, 1945, ch. 20, § 1, 59 Stat. 33 (codified at 15 U.S.C. §§ 1011-1015).

A bill was introduced in the Senate on January 18, 1945. *See* Journal Of The Senate 40 (1945). A similar bill, after being introduced in the House, was tabled. *See* 91 Cong. Rec. 1094 (1945). Senate Bill 340, entitled "A bill to express the intent of the Congress with reference to the regulation of the business of insurance," was reported on a week later, January 25, 1945. *See* 91 Cong. Rec. 478 (1945). The two houses disagreed in regards to an amendment to the bill, and as a result, the bill was directed to a conference committee.

The point of contention between the House and Senate which necessitated sending the bill to conference concerned an amendment by Senator Ferguson, making the Sherman and Clayton Acts applicable to the states in the area of insurance. *See* 91 Cong. Rec. 1480 (1945). The House disagreed with Senator Ferguson's amendment. *See* 91 Cong. Rec. 1481 (1945).

The subsequent conference report was a compromise which made the Sherman and Clayton Acts applicable to the states "to the extent that such business is not regulated by state law." *See* 15 U.S.C.A. § 1012(b). The conference report, then, had the effect of reaching an agreeable compromise whereby state legislatures were precluded from authorizing violation of the Sherman and Clayton Acts with respect to boycott, coercion, or intimidation. *See* 15 U.S.C.A. § 1013; 91 Cong. Rec. 1487 (1945). This compromise serves as an indication that Congress did mean what it said in the language of the Act; namely, that federal law is pre-emptive of state law in the insurance area only where the state statutory scheme is silent regarding a matter which Congress has passed a general piece of legislation covering, or where Congress has passed legislation specifically relating to the business of insurance. *See* 15 U.S.C.A. §§ 1011-1012. Read conjunctively, no other result can flow from the first two sections of the

Act. Moreover, in light of the disagreement between the two houses regarding the application of federal antitrust laws, and especially considering that the Act's third section provided for a three year moratorium on the application of certain federal laws, no other result can obtain. *See* 15 U.S.C.A. §§ 1011-1013. That is, the Act contemplates, and the compromise resulting from the conference report confirms, that the Act had a dual purpose: (1) to meet the crisis created by the *South-Eastern Underwriters* decision head-on and thereby effectuate an immediate remedy for the insurance industry (thus the moratorium in § 1013); and (2) to provide a long range scheme whereby the states would continue their traditional control over all aspects of the insurance industry (thus the broad language in §§ 1011-1012).

Congress intended to *restore* the control of the insurance industry to the states. *See* 91 Cong. Rec. 485 (1945). Congress was trying to make it clear to the states that the federal government was removing itself "as far as possible" from the regulation of the insurance industry. *See id.* at 1090. As such, the underlying notion that the regulation of the insurance industry should be under state auspices is the linchpin of speeches presented during Congressional debate. *E.g., id.* at 1482. Indeed, the "important thing" in the bill was said to be "that it [the bill] would put the regulation of the insurance business in the hands of the States." *Id.* at 487.

To accomplish this result, the Act was designed to be applicable to federal statutes then in existence and to federal statutes enacted after the Act's effective date which do not specifically relate to insurance. *See id.* at 479. It would be accurate to say, therefore, that the intent of Congress was to allow the states to "do the various other things [besides issue permits and collect taxes] which are necessary to be done" in the regulation of the insurance industry, and to "function freely" in handling such matters. *See id.* at 483.

The intent of Congress has been recognized by the Courts. They have stated that the dominant purpose of Congress in passing the Act was to give broad support to existing and future

state systems for regulating and taxing the business of insurance. *See, e.g., Securities Exch. Commn. v. National Sec., Inc.*, 393 U.S. 453 (1969); *Wilburn Boat Co. v. Fireman's Fund Ins. Co.*, 348 U.S. 310 (1955); *Prudential Ins. Co. v. Benjamin*, 328 U.S. 408 (1946); *Allstate Ins. Co. v. Lanier*, 361 F.2d 870 (4th Cir.), *cert. denied*, 385 U.S. 930 (1966). Thus, the Act reveals Congressional intent that states should *continue* regulating the insurance business where Congress has not expressly pre-empted the subject. *See Panhandle Eastern Pipe Line Co. v. Public Serv. Comm'n.*, 332 U.S. 507 (1947). Inasmuch as the Act intended to return the primary responsibility for insurance regulation to the states, only when the state has not acted will federal legislation become effective as to the area of insurance. *See Monarch Life Ins. Co. v. Loyal Protective Life Ins. Co.*, 326 F.2d 841 (2d Cir. 1963), *cert. denied*, 376 U.S. 952 (1964).

The exemption from federal control provided for under the Act applies to any area covered by state insurance laws; thus, the areas of regulation reserved for state control are determined not by the area's nature or importance but by whether a state has chosen to occupy it. *See Lawyers Realty Corp. v. Peninsula Title Ins. Co.*, 428 F. Supp. 1288 (E.D. La. 1977), *aff'd*, 550 F.2d 1035 (5th Cir. 1977). The proper test in interpreting the Act's parameters is to inquire whether the federal statute sought to be applied invalidates a state law regulating the practice of insurance. *See Miller v. National Fidelity Life Ins. Co.*, 588 F.2d 185 (5th Cir. 1979). Where, therefore, a state has authorized certain standards of conduct by setting forth a comprehensive scheme for regulating the insurance industry, the state scheme pre-empts general federal legislation. *See Ohio AFL-CIO v. Ins. Rating Bd.*, 451 F.2d 1178 (6th Cir. 1971). The Act thereby allows state regulatory schemes to proscribe, permit, or otherwise regulate insurance activities which but for the Act would violate federal laws. *See Seasongood v. K & K Ins. Agency*, 548 F.2d 729 (8th Cir. 1977).

Clearly, Congress was interested in preserving state regulation over the insurance industry, and its myriad issues; not just some limited aspect of it, like the insurance policy. This intent is

clearly articulated in § 1011 of the Act (Amicus Appendix 1a). When read in the context of the events leading to its enactment, the scope of the Act is not so limited as advocated by Petitioner. Accordingly, it is quite apparent that by passing the Act, Congress intended to keep traditional state-regulation of the insurance industry outside the realm of federal regulation. Congress did not intend to limit state regulation to the issuance of the insurance policy. Rather, the scope of exclusive state regulation deliberately extended to the entirety of the insurance industry, in recognition of the fact that such regulation, from cradle to grave, must be comprehensive in order to effectuate the states' police power in protecting policyholders.

The insurance industry involves a vital public interest and its regulation is not just a matter of public policy, but is in fact, a matter which rests firmly within the police power of the several states. *See, e.g., California State Auto. Assoc. Inter-Insurance Bureau v. Maloney*, 341 U.S. 105, 109-110 (1951); *Ozborn v. Oslin*, 310 U.S. 53, 65 (1940); *German Alliance Ins. Co. v. Hale*, 219 U.S. 307, 316-17 (1911). Insurance receiverships are key elements of this police power exercised for the protection of the insurance buying public and providing for the stability of the insurance system as a whole. *See, e.g., Baldwin-United Corp. v. Garner*, 678 S.W.2d 754 (Ark. 1984), *cert. denied*, 471 U.S. 1111 (1985); *Carpenter v. Pac. Mut. Life Ins. Co.*, 74 P.2d 761 (Cal. 1937), *aff'd sub nom. Neblett v. Carpenter*, 305 U.S. 297 (1938). The states are able to ensure equitable treatment for creditors and avoid preferences upon the liquidation of an insurer by providing that any matter affecting the assets available for distribution be the subject of a single integrated administration. *Eden Financial Group, Inc. v. Fidelity Bankers Life Ins. Co.*, 778 F. Supp. 278 (E.D. Va. 1991); *Knickerbocker Agency, Inc. v. Holz*, 4 A.D.2d 71, 73, 162 N.Y.S.2d 822 (N.Y.A.D. 1957), *aff'd*, 149 N.E.2d 885 (N.Y. 1958); *see also Schacht v. Brown*, 711 F.2d 1343 (7th Cir.), *cert. denied*, 464 U.S. 1002 (1983) (the policy underlying the statutory liquidation process is "the protection of the interests of policyholders, shareholders and creditors jointly" by the receiver); *Metropolitan Life Ins. Co. v. Board of Directors of Wisconsin Ins.*

Sec. Fund, 572 F. Supp. 460 (W.D. Wis. 1983); *Consumers Super Market No. 2, Inc. v. Underwriters at Lloyds*, 189 So. 2d 648 (Fla. Dist. Ct. App. 1966).

Both the plain language of the Act and its legislative history support the conclusion that, except as to antitrust matters, the states are to regulate the insurance industry without interference from the federal government, with the exception of antitrust matters, until such time as Congress expressly directs otherwise. In short, the regulation of insurance is, by operation of *McCarran-Ferguson*, left exclusively to the states except with respect to:

(1) federal statutes specifically relating to the business of insurance; and

(2) the Sherman Act, the Clayton Act and the FTC Act.

No argument is advanced (and none could be sustained) that the *Federal Priority Statute* is either specifically related to the business of insurance or part of these antitrust statutes. Accordingly, if the Ohio statute in issue is part of Ohio's regulation of insurance, it controls over the *Federal Priority Statute*.

B. The Liquidation Of An Insurance Company Is The "Business Of Insurance"

Conflicts between the attempted application of federal non-insurance statutes to troubled or insolvent insurers and the exclusive regulation of the insurance industry by the states are much in vogue and, in the main, focus on the definition of "business of insurance". This is because the argument is often advanced that Congress has left to the exclusive regulation of the states only the "business of insurance" and that much of what is involved in the rehabilitation or liquidation of insurers does not fall within that universe. In support of these inroads into state regulation of the industry, torturous and hyper-technical analyses are made seeking to carve out a narrow subset of the activities in which insurers engage as constituting the "business of insurance", placing all other activities of the industry in a

broader universe alleged to fall outside the province of exclusive state regulation. While, in some respects, intellectually appealing, this approach is misguided and flies in the face of the public policy underlying the *McCarran-Ferguson Act* and this Honorable Court's decisions on point. This Court has long understood exactly what Congress left to the states in 1945 and, when fairly read, its decisions cannot be reasonably interpreted as contrary to that understanding.

1. The *National Securities* Test

Notwithstanding the plain language of the statute, and its legislative history, as both Petitioner and Respondent point out, there has been substantial debate about the meaning of the "business of insurance". In attempting to reach a resolution of the issue, this Court has applied different tests to the two parts of § 1012 (Amicus Appendix 1a). For the first part, this Court has prescribed a broad test to give to states the intended regulatory exclusivity, consonant with the sense of Congress, that insurance is better addressed by the states, rather than the nation. For the antitrust exemption, the second part of § 1012, a narrower test is expressed to give limited state immunity from federal antitrust laws, and further the nation's undisputed interest in regulating interstate commerce.

The Court articulated the test for the first part of § 1012 in *Securities Exch. Commn. v. National Sec., Inc.*, 393 U.S. 453 (1969). The Court stated that to qualify as the "business of insurance" an activity must either directly or indirectly affect the relationship between the insurer and the insured. *Id.* at 460 At the core of this relationship is the type of policy which is issued, its reliability, interpretation, and enforcement. *Id.* Additionally, other activities of insurance companies which relate closely to their status as reliable insurers are the "business of insurance." "[W]hatever the exact scope of the statutory term, it is clear where the focus was — it was on the relationship between the insurance company and the policyholder. Statutes aimed at protecting or regulating this relationship, directly or indirectly, are laws regulating the "business of insurance." *Id.* Clearly, then, a

liquidation proceeding must be the "business of insurance", as it is the final step in a state's efforts to protect the interest of the policyholder. In a liquidation proceeding, the relationship between the policyholder and the insurance company is of paramount importance. The very purpose of the liquidation scheme is to fulfill the obligations of the insolvent insurance company to its policyholders by providing for the adjustment and payment of claims in a prescribed order. Because most insolvent companies will not have sufficient assets to satisfy all creditors, the order of distribution is crucial.

Ensuring satisfaction of policy obligations is directly related to the reliability and enforcement of the insurance contract. Accordingly, the priority statutes are a fundamental component of an insurance company's reliability, and a mechanism upon which insureds can rely in their purchase of insurance products. The state does not create an arbitrary system of payment. Rather, the order of distribution in liquidation is analogous to the payments the company makes while viable: obligations to policyholders are first, followed by the other obligations of the company. Nothing within Petitioner's argument suggests otherwise, or that it should be otherwise. Thus, in many respects, the allocation of an insurer's assets in state liquidation proceedings seeks to fulfill the contractual undertakings on the strength of which it obtained such assets in the first place, i.e., its policy obligations. To that extent, therefore, the liquidation proceeding does nothing more than continue the substance of the relationship between the insurer and its insured, seeking as much as possible to "honor their bargain". Neither prudence nor logic supports the position that insurance companies should set aside special reserves for any liability that might be asserted by the federal government, as would in fact be required if the law were what Petitioners suggest it should be. This is especially so in the present context, where, at best, the federal government is no more than the beneficiary of an insurance policy. This is not to suggest that obligations to the federal government are not important — they are. But in the context of insurance regulation, they are no more compelling than obligations to policyholders. Any other result leads only to chaos and unexpected and unanticipated artificial influences in the open market. [1]

The liquidation proceeding necessarily implicates the transfer or spreading of a policyholder's risk and is an integral part of the relationship between insurer and insured. The liquidation of an insurer is directed at maximizing the interests of its policyholders and is a key element of a state's regulation of the business of insurance. The Petitioner's simplification of liquidation notwithstanding, in order for the Court to find that a liquidation is not the "business of insurance," it must ignore this pivotal relationship and its risk-spreading character. State laws protecting or regulating the relationship between the insurance company and the policyholder, either directly or indirectly, such as laws providing for the rehabilitation, liquidation or dissolution of insurers, are "laws regulating the business of insurance." *E.g., Washburn v. Corcoran*, 643 F. Supp. 554, 556 (S.D.N.Y. 1986).

The Sixth Circuit correctly found that:

---

[1] If the law clearly established a super priority for the federal government in the allocation of assets upon rehabilitation or liquidation of an insurer, insurers which marketed their coverages to federal agencies would, of necessity, become less attractive to commercial insureds. That is so because such insureds would recognize that if the carrier became insolvent, their claims against its assets would be subordinate to those of the federal government. And note further that the proposition that this issue applies to entities eligible for bankruptcy relief and not to insurers (which unquestionably are not so eligible) might lead to further surprising results. Thus, health maintenance organizations are, at least arguably, eligible for bankruptcy relief. *See, e.g., In re Family Health Services*, 101 B.R. 618 (Bankr. C.D. Cal. 1989). Buyers of health care coverage might choose to obtain such protection from HMOs in the belief that upon the financial demise of such an entity their claims against the assets would not be inferior to those of the federal government since the federal priority act does not apply to bankruptcy proceedings. By contrast, if they were to obtain such coverage from indemnity health insurers, such buyers could expect their claims against the entity (if it were to become insolvent) to be inferior to those of the federal government. And while most insureds do not anticipate that their carrier will become insolvent, the frequency with which that has occurred in recent times has led most sophisticated purchasers to plan for that as a potential contingency.

> *[The State's priority statute] is designed to support and undergird the entire contractual process between insurer and insured, as implicitly recognized by the parties, by transferring the risk of insolvency immediately upon contracting. Just as the regulatory scheme of the Federal Depositor Insurance Corporation regulates the business of banking for the protection of depositors, [the priority statute] regulates the business of insurance for the protection of policy holders.*

Fabe v. United States Dept. of Treasury, 939 F.2d 341, 351 (6th Cir. 1991).

Further, and contrary to Petitioner's assertion, an insolvent insurance company does not "cease to exist" nor does the relationship between the insurer and insured "terminate." *Petitioner's Brief at 8.* An insolvent insurer usually does not forfeit its charter until the liquidation is complete. More importantly, the insurance relationship does not cease to exist simply because a state insurance commissioner is now performing the duties of the insurer. The Commissioner must continue to adjust and pay claims of the policyholders[2] which arise out of the insurance contract — the very source of the insurance relationship. The fact that a Commissioner administering an insurance liquidation generally does not create new insurance relationships with new policyholders has no bearing on the existing contracts. By Petitioner's own admission, "a liquidator may continue to engage in aspects of the business of insurance during the liquidation . . . " *Petitioner's Brief at 15 n.5.*

It is nothing short of the epitome of sophistry to pretend that financial deterioration of an insurer (over which its customers have no control) fundamentally changes *the relationship* between it and its insureds so that the latter may no longer realize the full benefits of the regulatory scheme under which the carrier operated in the first instance. There can be little doubt

[2] *See, e.g., Ohio Rev. Code Ann.* § 3903.42 (Page 1989).

that those insureds continue, even in insolvency, to rely upon the company to provide indemnification and other insurance coverages. That the company may no longer be capable of fulfilling its contractual obligations in the way in which it had promised in no way diminishes its customers' reliance on precisely that coverage. That the individual states seek to replace the company's pre-insolvency ability to fulfill such obligations with statutory constructs designed to provide reasonable substitutes should in no manner justify the interposition of a new set of legal constraints the effect of which is to undermine the ability of the states to deliver the intended protection.

Most telling about the Petitioner's position, though, is the fact that the insurance company cannot start a proceeding in the bankruptcy court. It is still an insurance company, even though in liquidation, and beyond the scope of the federal bankruptcy laws. 11 U.S.C.A. § 109(b)(2) and (d); *In re Union Guarantee & Mortgage Co.*, 75 F.2d 984, 985 (2d Cir.), *cert. denied*, 296 U.S. 594 (1935); *In re Peoria Life Ins. Co.*, 75 F.2d 777, 778 (7th Cir.), *cert. denied*, 296 U.S. 594 (1935); *In re Equity Funding Corp. of America*, 396 F. Supp. 1266, 1275 (C.D. Cal. 1975); *In re National Surety Co.*, 7 F. Supp. 959, 961 (N.D.N.Y. 1934). If Petitioner's position were true, that this is a mere corporation distributing its limited assets, there would not need to be that exemption from the bankruptcy laws; yet such exemption remains. The significance of this exemption is not merely in its existence, but in the implication it has for Petitioner's core argument. If the insurance company in liquidation is nothing more than any other company, and should be in bankruptcy, then the federal priority statute would not apply, and Petitioner would have no case to argue today.[3]

[3] The federal priority statute does not apply in proceedings under the federal bankruptcy code. See Act of Nov. 6, 1978, Pub. L. No. 95-598, § 322(a), 92 Stat. 2678 (codified at 31 U.S.C.A. § 3713 (2)).

The federal priority statute was removed from application to bankruptcy proceedings because it did not generate any meaningful recovery to the government, and because the federal government, for the most part, was pursuing contractual claims for which it should receive no greater treatment than other creditors. Further, there was a recognition of the fact that the federal government was better able to bear the loss, since it could distribute it among all taxpayers, than other creditors who bear the brunt of their own loss.[4] This reasoning was recognized almost 70 years ago:

> *No sound principle of public policy can be invoked in support of preference to the federal government and to the states over citizens in the collection of ordinary debts. On the contrary, the contractual operations of the federal government and of the states have become so extensive and so involved with the business of private citizens that priority to the federal government and to the states, except for taxes, would operate as an oppressive hardship on other creditors of bankrupts.*

Davis v. Pringle, 1 F.2d 860, 864 (4th Cir. 1924), *aff'd*, 268 U.S. 315 (1925).

Noticeably absent from Petitioner's brief is any explanation why the liquidation proceeding of an insurance company should receive less dignity than a bankruptcy proceeding of a non-insurance company. The immediate answer is that there is no logical reason for excluding the priority statute from bankruptcy application, but not analogous liquidation proceedings in a state court. Indeed, the reason for not applying the priority

[4] *See Communication from the Executive Director*, Commission on the Bankruptcy Laws of the United States, House Doc. no. 93-137, Part 1, p. 216-218, July 1973; *Proposed Legislation and Recent Developments on Lien Priorities*, 4 Real Prop., Prob. & Trust J. 413, 414-415 (Spring 1969); *Report of the ABA Ad Hoc Committee To Study the Federal Priority in Insolvency*, 21 Real Prop., Prob. & Trust J. 673 (1986).

statute in the context of an insurance company liquidation is more compelling than in the bankruptcy context. Policyholders have given their money in trust to the insurance company to protect against certain assumed risks, knowing that even if the company fails, the trust funds will still be accorded the dignity of the trust *res* to the extent possible.

The reasoning behind this "hands off" approach to insurance insolvency by federal bankruptcy courts was clearly articulated by the Fourth Circuit Court of Appeals in *Sims v. Fidelity Assur. Ass'n.*, 129 F.2d 442 (4th Cir. 1942), *aff'd on other grounds*, 318 U.S. 608 (1943). In speaking of the exception of insurance companies from bankruptcy protection, the 4th Circuit stated:

> *[R]easons for making these exceptions may be surmised to lie in the public or quasi-public nature of the business, involving other interests than those of creditors, in the desirability of unarrested operation, the completeness of state regulation, including provisions for insolvency, and the inappropriateness of the bankruptcy machinery to their affairs.*
>
> *All states, probably, have in fact regulated insurance companies of all kinds, and provided for their liquidation. The affairs of an embarrassed or insolvent insurance company often require much technical skill and judgment and time for their adjustment and a carrying forward of the business, to prevent lapses and to permit reinsurance to simplify them (quoting In re Supreme Lodge of the Masons Annuity, 286 F. 180, 184 (D.C. Ga. 1923)).*
>
> . . .
>
> *It was considered that it would be a ruinous thing to the state, to the depositors, and to the creditors to have the elaborate scheme of liquidation which the state provides broken into and*

> *nullified by bankruptcy proceedings, and it was intended by withdrawing jurisdiction over these corporations from the bankruptcy court, that this would not occur (quoting Woolsey v. Security Trust Co., 74 F.2d 334, 337 (5th Cir. 1934)).*
>
> . . .
>
> *The most natural inference is that Congress meant to leave to local winding up statutes the liquidation of such companies; that, since the states commonly kept supervision over them during their lives, it was reasonable that they should take charge on their demise.*

Id. at 448-49.

Little logic can be found in an argument that Congress determined to permit the states to effect regulatory protection for the purchasers of insurance but that such protection should be so construed as to confer upon the creditors of companies so regulated a status inferior to that of creditors of business enterprises whose demise is governed by federal bankruptcy laws. Indeed, there is no logical reason for excluding the priority statute from bankruptcy application, but not analogous liquidation proceedings.[5]

[5] The Petitioner notes the fact that the federal priority statute does not apply in the bankruptcy context, and concludes from the enactment of that clarification in 1978, and the revision of the federal priority statute in 1982 that Congress did not intend for there to be any waiver of the priority in the non-bankruptcy context. *Petitioner's Brief at 10-11 n.3.* This is a non-sequitur on the part of Petitioner. Having specifically provided in the Act that non-specific federal laws would not preempt the state regulation of insurance, it was not for Congress to reaffirm this position. Rather, in the absence of any modification of the federal priority statute, Congress must have intended that it not apply to insurance company liquidations.

Recognizing this long-standing federal deference to state regulation, the *National Securities* test envisions a result whereby the liquidation of the insurance companies is included within the integrity of state regulation of insurance, and therefore, beyond the application of the federal priority statute, since it is not specifically directed toward the regulation of insurance.

2. *The Royal Drug-Pireno Test*

a. The *Royal Drug* and *Pireno* Definitions of the Business of Insurance have been applied so as to frustrate Congressional Intent

Subsequent to *National Securities,* this Court articulated and refined a test for the meaning of the "business of insurance" in the antitrust context. *Group Life & Health Insurance Co. v. Royal Drug,* 440 U.S. 205 (1979), *cert. denied,* 469 U.S. 1160 (1985), and *Union Labor Life Ins. Co. v. Pireno,* 458 U.S. 119 (1982) (the *Royal Drug-Pireno test*). This test is a three part inquiry: (1) whether the practice has the effect of transferring or spreading a policyholder's risk; (2) whether the practice is an integral part of the policy relationship between the insurer and the insured; and (3) whether the practice is limited to entities within the insurance industry. *Pireno,* 458 U.S. at 129.[6]

The *Royal Drug-Pireno* test is quite different from the *National Securities* test. It has been interpreted to include only "horizontal" transactions or those between the insurer and the insured. As noted by the dissent in *Royal Drug,* this test excludes from state regulation provider agreements, advertising agreements, agreements between insurers (such as cooperative ratemaking and pooling of loss data) and the peer review process, among other activities, because the only parties involved in these activities are insurance companies and third parties — not policyholders. *Royal Drug,* 440 U.S. at 243-246 (Brennan, J.,

[6] There is some question whether one or all three components of the inquiry must be satisfied. *Gordon v. United States Dept. of Treasury,* 846 F.2d 272 (4th Cir.), *cert. denied,* 488 U.S. 954 (1988). That issue does not need to be decided here, though, since all three elements are met.

dissenting); *see also Pireno*, 458 U.S. at 136 (Rehnquist, J., dissenting). Extending this result so as to restrict the state's regulatory authority outside the context of antitrust disputes is contrary to Congress' intent. Some provider agreements must necessarily be made to provide insureds with the bargained-for benefits. This directly affects the relationship between the insurer and the insured. Additionally, agreements between two or more insurers or insurers and certain third-parties directly affect the cost to the insured. Both this Court and Congress have recognized these activities as within the scope of the Act. *Federal Trade Commission v. National Casualty Co.*, 357 U.S. 560 (1958) (insurance advertisement); 91 Cong. Rec. 1481, 1484 (1945) (cooperative ratemaking agreements); 90 Cong. Rec. 6538 (1944) (other vertical agreements). State regulation of these activities is a vital component of the states' regulation of insurance and should not be excluded in a misguided expansion of a reasonable application of congressional intent that insurers not be shielded from the application of certain federal antitrust laws. The states, being on the front line of insurance regulation, are best suited to this regulatory effort, as has been historically recognized.

b. *Royal Drug* And *Pireno* Are Irrelevant To Liquidation Proceedings

Even if this Court finds that the *Royal Drug-Pireno* test accurately reflects Congressional intent, the holding of the Sixth Circuit must still be affirmed. The *Royal Drug-Pireno* test is limited to the antitrust exemption, which is not implicated in this case. As stated by the *Royal Drug* court:

> *The primary concern of Congress . . . was in enacting legislation that would ensure that the States would continue to have the ability to tax and regulate the business of insurance. This concern is reflected in §§ 1 and 2(a) of the Act, neither of which is involved in this case. A secondary concern was the applicability of the antitrust laws to the insurance industry.*

> *The question in the present case . . . is one under the quite different secondary purpose of the McCarran-Ferguson Act to give insurance companies only a limited exemption from the antitrust laws. The repeated insistence in the dissenting opinion that the McCarran-Ferguson Act should be read as protecting the right of the States to regulate what they traditionally regulated is thus entirely correct — and entirely irrelevant to the issue now before the Court . . . for the question here is not whether the McCarran-Ferguson Act made state regulation of these Pharmacy Agreements exempt from attack under the Commerce Clause. It is the quite different question whether the Pharmacy Agreements are exempt from the antitrust laws.*
>
> *In short, the McCarran-Ferguson Act freed the States to continue to regulate and tax the business of insurance companies, in spite of the Commerce Clause. It did not, however, exempt the business of insurance companies from the antitrust laws.*

Royal Drug, 440 U.S. at 217-18 & n.18.

Likewise, in *Pireno*, another antitrust case, Justice Brennan recognized that the Court's opinion was applicable only to the narrow antitrust exemption. Thus, he stated, "the question before us is controlled by *Royal Drug* . . . *Royal Drug* identified three criteria relevant in determining whether a particular practice is part of the 'business of insurance' exempted from the *antitrust laws*." *Pireno*, 458 U.S. at 126, 129. It is significant that the Court held that *Pireno* was not controlled by *National Securities* because the Court was construing the antitrust exemption of the *Act* and not the general preemption given to States in other insurance matters. In fact, *National Securities* was mentioned

only twice in the majority opinion, both times indirectly.[7] Significantly, *Pireno* distinguished itself from those cases involving claims adjustment:

> *The premise of the dissent is that NYSCA's Peer Review Committee actually constitutes "the claims adjustor" in this case . . . from this premise the dissent reasons that since "claims adjustment is part and parcel of the "business of insurance" protected by the McCarran-Ferguson Act," . . . it necessarily follows that the peer review practices at issue in this case must enjoy the Act's exemption. The fatal flaw in this syllogism is that NYSCA's Peer Review Committee is not the claims adjustor.*

Pireno, 458 U.S. at 134 n.8. The claim adjustment process is not materially different from the liquidation of policyholder accounts. The liquidator in the case before the Court today *is* the claims adjustor. Thus, by the explicit holding in *Pireno,* the liquidation proceeding is "part and parcel of the 'business of insurance' protected by the *McCarran-Ferguson Act.*" *Pireno* 458 U.S. at 134 n.8.

Petitioner asks this Court to apply *Royal Drug* and *Pireno* to the matter at hand.[8] However, for this Court to find that the *Royal Drug-Pireno* test should be interpreted to exclude from the

[7] The first time is on page 131 where the *Pireno* court quotes *Royal Drug* quoting *National Securities*. The second time is at page 133 quoting Petitioner's Brief quoting *National Securities*.

[8] In fact, Petitioner would have the Court apply a new and more stringent test of its own creation, that a State regulation must be "integral to the contractual relationship between the insurance company and the insured . . . and [to] whether the policyholder has a valid contractual claim against the insurer." *Petitioner's Brief* at p. 19-20. This test not only ignores the historical context of insurance regulation, but it also engages in aggressive revisionist rewriting in an unfounded attempt to further federal regulatory expansionism. This is an ironic twist for republican administrations.

McCarran-Ferguson protection the state's insurance rehabilitation and liquidation statutes would amount to a declaration that *Pireno* and *Royal Drug* overruled *National Securities.* Further, it would be directly contrary to the respective holdings of each of those decisions, as shown above. Such a result is unwarranted, particularly on the facts of this case.[9]

C. Historically, Liquidation Schemes Have Been The Exclusive Province Of The States

Even before passage of the Act, state insurance receivership were viewed as the domain of the states, not to be interfered with at the federal level. *See, e.g., Holley v. General Am. Life Ins. Co.,* 101 F.2d 172 (8th Cir.), *cert. denied,* 307 U.S. 619 (1939). *Holley* was a suit to set aside a disposition of assets of an insolvent Missouri insurer, for the appointment of a receiver by the federal court, and for an accounting under its direction and control. The *Holley* court did not entertain the federal involvement in the Missouri liquidation. Instead, it observed:

> *It seems so plain to us that the complainant and the intervener are seeking the interference of the federal court in a matter within the exclusive jurisdiction and control of the state court of Missouri . . . That court not only had jurisdiction, but it had exclusive jurisdiction (citing, Lion Bonding & Surety Co. v. Karatz, 262 U.S. 77 (1923)). It was for that court to determine what the statutes of Missouri permitted or required with respect to the disposition of the trust estate . . .*

* * *

[9] Arguably, this whole issue can be avoided by treating Petitioner as a policyholder. Petitioner does not appear to argue that as a policyholder it should be treated more favorably than other policyholders. *Petitioner's Brief* at 11 n.4.

> *Moreover, it is the established rule that the liquidation of a domestic insurance company under the laws of the state of its domicile, where such laws furnish a comprehensive method of the winding up of its affairs by an officer of the state under the jurisdiction of a court of the state, cannot be interfered with by a federal court (citing, Lion Bonding & Surety Co. v. Karatz, 262 U.S. 77 (1923)).*

Id. at 174.

Petitioner seeks to avoid this history primarily through its reliance on the decision in *United States v. Knott,* 298 U.S. 544, (1936). The Petitioner holds this decision out for the proposition that, historically, the federal priority statute preempted the priorities of state liquidation schemes. It asserts that even if the Act was designed to "turn back the clock" to pre-*South-Eastern Underwriters, Knott* indicates that the federal priority statute trumped a state priority scheme even before the Act. *Petitioner's Brief at 8, 24-26.* Petitioner's argument in this respect fails for two reasons: first, although *McCarran-Ferguson* certainly sought to reverse the perceived ill-effects of *South-Eastern Underwriters* it does not follow that the only result of the statute's enactment was to restore the law to *exactly* what it was before the case that prompted it. Secondly, Petitioner reads too much into *Knott.*

The effect of *McCarran-Ferguson* is discernable from a review of the plain language of the statute. It left to the states exclusive regulation of insurance ***except*** with respect to federal statutes specifically relating to the business of insurance and certain antitrust statutes. Whatever the law may have been before *South-Eastern Underwriters,* the law after *McCarran-Ferguson* is clear: all aspects of the regulation of insurance are left exclusively to the states ***without regard to the provisions of federal statutes not specifically relating to the business of insurance.*** To that extent, therefore, *Knott* is inapposite.

Nor does *Knott* help in resolving the issue before the Court. The case involved a state law which protected a surety's domestic creditors by giving them a preference over foreign creditors. It did not involve a specialized regulatory priority scheme with policyholders competing against the federal government.

A New Jersey insurance company had been put into receivership in New Jersey. When the liquidation began, there were no unsatisfied judgments against it in Florida, where it also transacted business. 298 U.S. at 544, 545. The receivership court in New Jersey assumed *in rem* jurisdiction over the company assets and the receiver set out to marshal them as the officer of the court. *Id.* The insurance company had deposited securities in Florida as required by law, to satisfy any claims against it. There was no ancillary receivership in Florida. After the start of the liquidation in New Jersey, Florida enacted a law which allowed a Florida court to distribute the insolvent insurance company's assets in that state to Florida creditors. A Florida creditor then began a suit against the insurance company in Florida seeking the assets. The United States intervened to satisfy its claim first.

This Court held that the United States could intervene in the Florida proceeding, and that its claim must be paid first. Important to the decision is the finding that the securities in Florida still belonged to the insurance company. 298 U.S. at 550. The Court stated that if title had been transferred from the company, the United States would not be entitled to priority. While the argument can be made that there had been a transfer of title in *Knott,* that is certainly the case here. The assets of the insurance company are in *custodia legis,* to be administered for the receivership court by the receiver. Title is not in the insurance company, the entity which is the debtor of the government.

The salutary purpose of state insurance receiverships is to treat all policyholders fairly and ratably. The very purpose of a receivership court's order enjoining litigation against the company is to protect the insurance company and its assets from the disruptive assertion of conflicting claims of policyholders and creditors. *Eden Financial Group, Inc. v. Fidelity Bankers Life*

Insurance Company, 778 F. Supp. 278 (E.D. Va. 1991). A receiver's primary duty in rehabilitating the company is to marshal all of the assets of the company in receivership, administering them in accordance with the orders of the receivership court and the provisions of the insurance code. *E.g., Motlow v. Southern Holding & Sec. Corp.*, 95 F.2d 721, 724-725 (8th Cir.), *cert. denied*, 305 U.S. 609 (1938). *See generally* 19A Appleman, Insurance Law and Practice, § 10681 (West 1981).

In short, the receiver holds all of the property and assets of the insurer as a fund for the use and benefit of the policyholders and creditors, to be administered in accordance with the provisions of state law, and the orders of the receivership court. *See, e.g., Sangamon Loan & Trust Co. v. Peoples Sav. & Trust Co.*, 204 Ill. App. 7 (1917); *In re Kinney*, 257 A.D. 496, 14 N.Y.S.2d 11 (1939), *aff'd*, 24 N.E.2d 494 (N.Y. 1939). The receiver is the representative of all policyholders and other creditors and has the duty to administer the assets of the company for the benefit of these policyholders and creditors. *Garris v. Carpenter*, 33 Cal. App. 2d 649, 92 P.2d 688 (1939) (duty of receiver includes duty to administer affairs of insolvent insurers for benefit of creditors, policyholders and the public). As such, the receiver of an insurance company not only represents the company but also represents it policyholders, the beneficiaries under the policies, the company's creditors, and is the representative of the public interest in the enforcement of the state's insurance laws as they apply to the policies of the insurance company. *See English Freight Co. v. Knox*, 180 S.W.2d 633 (Tex. Civ. App. 1944).

In *Clark v. Williard*, 292 U.S. 112 (1934) this Court warned of the danger of "allow[ing] the assets of an insolvent corporation to be torn to pieces at the suit of rival creditors when they could be distributed equally and without sacrifice at the hands of a receiver." This warning is particularly appropriate for insurance companies in receivership, and warrants rejection of Petitioner's attempt to elevate its position through the use of the *Federal Priority Statute*. The United States is making a claim on assets owned by the court for the benefit of creditors of the

insurance company. Accordingly, under the rationale of *Knott*, the priority statute does not apply. This is the essence of the holding in *Conway v. Imperial Life Ins. Co.*, 21 So. 2d 151 (La. 1945).

In *Conway*, the Imperial Life Insurance Company had deposited approximately $45,000 with the State Treasurer to enable it to qualify to conduct an insurance business in Louisiana. The Louisiana statute provided that the bond was to be held in trust for the benefit and protection of the company's policyholders. Subsequently, Imperial became insolvent, and a receiver was appointed. The receiver filed a table of debts, listing the United States as an ordinary creditor concerning certain taxes. The United States claimed that it was entitled to priority under the *Federal Priority Statute*. The trial court found against the United States, which was upheld on appeal.

On appeal, the United States argued that *Knott* controlled the decision. The Louisiana Supreme Court, however, distinguished *Knott* on two grounds, one of which is relevant here. The Court noted that the statute specifically provided that the bond was to be held in trust for the use and benefit of the policyholders, whereas the Florida statute concerned in *Knott* contained no such express language. The Court reasoned that the very purpose of the Louisiana law, the protection of policyholders, must be effectuated, and thus, "the claim of the policyholders to the fund in question must prevail over the claim of the United States."

In the context of the present case, where the receivership court and the receiver are holding the assets of the insolvent insurance company in trust for the protection of policyholders and creditors, it is unfair and inappropriate to violate that trust by allowing the federal government a preference.

D. *McCarran-Ferguson* Precludes Application Of The *Federal Priority Statute, 31 U.S.C. § 3713* To A Liquidation Proceeding

Congress intended for the states to regulate the insurance industry in the absence of specific federal legislation. The liquidation of an insurance company is an integral part of a state's regulation. Because the *Federal Priority Statute* is not a specific act directed toward the regulation of insurance, it cannot supplant the efforts of the state. Nothing in the *Federal Priority Statute* indicates that Congress intended that it specifically relate to the business of insurance. In fact, no mention of insurance is made. Congress could have wholly or partially shielded the *Federal Priority Statute* from the effect of the Act if that had been its desire, as it did with the *Sherman Act*, the *Clayton Act*, the *Federal Trade Commission Act*, the *Robinson-Patman Act*, the *National Labor Relations Act*, the *Fair Labor Standards Act*, and the *Merchant Marine Act. See* 15 U.S.C. §§ 1012-1014. The *Federal Priority Statute* has been in existence and actively in use since 1797. Thus, Congress was well aware of its presence and could have provided for it to trump the Act if it had so intended. Because it did not and because a liquidation is "the business of insurance," the supremacy of state law under the Act forbids its application to a state's priority statute in the liquidation of an insurance company. To allow the federal government to assert a priority pursuant to the statute would allow for the very federal interference that Congress intended to prevent.

CONCLUSION

The relationship between the policyholder and the insurer is of paramount significance in a liquidation proceeding where the efforts of State authorities are directed at preserving assets for the protection of the policyholders and the public. To allow the federal government to assert its priority statute would create the very real threat that control of the states' insurance liquidations would be removed from the hands of the proper state authorities and add chaos to a situation begging for stability.

Moreover, the salutary purpose of state insurance liquidations, of treating all policyholders and creditors fairly and ratably, would be circumvented if the Department of the Treasury were allowed to have its claim adjudicated in a manner inconsistent with the rights and claims of other claimants and policyholders. If the Court sustains the federal government's priority claim, it will start the dismantling of the entire state regulatory insurance scheme at the expense of policyholders, and defeat the fundamental objective of the *McCarran-Ferguson Act.* Congress expressly directed that the states should wholly regulate insurance. In this case the State of Ohio seeks to do exactly that in the most compelling circumstances. Accordingly, the opinion of the United States Court of Appeals for the Sixth Circuit should be affirmed.

PATRICK H. CANTILO
HAROLD B. GOLD
RANDOLPH N. WISENER
JILL C. ADLER

BY: ______________________

RUBINSTEIN & PERRY, LLP
2000 LINCOLN PLAZA
500 NORTH AKARD STREET
DALLAS, TEXAS 75201
(214) 740-4600

September 1992

Appendix

15 U.S.C. § 1011

Congress declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.

15 U.S.C. § 1012

(a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

(b) No act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: *Provided,* That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

(10)

No. 91-1513

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

UNITED STATES DEPARTMENT OF THE TREASURY AND MITCHELL A. LEVINE, ASSISTANT COMMISSIONER,

Petitioners,

—v.—

GEORGE FABE, SUPERINTENDENT OF INSURANCE, STATE OF OHIO,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF *AMICUS CURIAE* OF SALVATORE R. CURIALE, SUPERINTENDENT OF INSURANCE OF THE STATE OF NEW YORK, AS LIQUIDATOR, IN SUPPORT OF RESPONDENT

William F. Jerome
State of New York
Insurance Department
Liquidation Bureau
123 William Street
New York, New York 10038

Mathias E. Mone
Counsel of Record
Adam Liptak
James R. Oswald
CAHILL GORDON & REINDEL
(a partnership including a professional corporation)
80 Pine Street
New York, New York 10005
(212) 701-3000

29

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Legislative History

Rules

Statutes

Other Authorities

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

No. 91-1513

UNITED STATES DEPARTMENT OF THE TREASURY AND MITCHELL A. LEVINE, ASSISTANT COMMISSIONER,

Petitioners,

—v.—

GEORGE FABE, SUPERINTENDENT OF INSURANCE, STATE OF OHIO,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF *AMICUS CURIAE* OF SALVATORE R. CURIALE, SUPERINTENDENT OF INSURANCE OF THE STATE OF NEW YORK, AS LIQUIDATOR, IN SUPPORT OF RESPONDENT

This brief *amicus curiae* is respectfully submitted on behalf of Salvatore R. Curiale, Superintendent of Insurance of the State of New York, in his capacity as Liquidator, Rehabilitator, Ancillary Receiver and Conservator of a number of insurance companies placed under his supervision pursuant to Article 74 of the New York Insurance Law. Pursuant to Rule 37 of the Rules of this Court, *amicus* has obtained and files herewith the written consent of each of the parties to the filing of this brief. *Amicus* supports Respondent George Fabe, Superintendent of Insurance of the State of Ohio.

INTEREST OF THE AMICUS CURIAE

Amicus is the Superintendent of Insurance of the State of New York and appears here in several capacities, including as liquidator of insolvent insurance companies chartered by or having their United States domicile in the State of New York.[1] These insurance companies are being liquidated in the courts of the State of New York under the provisions of the New York statute governing the rehabilitation and liquidation of insolvent insurance companies, Article 74 of the New York Insurance

1 *Amicus* is liquidator of 44 insolvent insurance companies domiciled in the State of New York: American Consumer Insurance Company, American Enterprise Insurance Company, American Fidelity Fire Insurance Company, Bakers Mutual Insurance Company of New York, Carriers Casualty Company, Citizens Casualty Company of New York, Consolidated Mutual Insurance Company, Constellation Reinsurance Company, Cosmopolitan Mutual Insurance Company, Dominion Insurance Company of America, Executive Life Insurance Company of New York, First Amvestors Life Insurance Company, First Northern Title Insurance Company, Fulton Reinsurance Company, Health and Welfare Association, Inc., Heartland Group Inc., Horizon Insurance Company, Ideal Mutual Insurance Company, Knickerbocker Insurance Company, Lincoln Central Life Insurance Company of America, Long Island Insurance Company, Manhattan Casualty Company, Massachusetts Life Insurance Company of New York, Midland Insurance Company, Midland Property and Casualty Insurance Company, Nassau Insurance Company, New Re Insurance Corporation, New England Life Insurance Company of New York, New York National Insurance Company, New York State Trial Lawyers Insurance Company, Northeastern Life Insurance Company of New York, Northumberland General Insurance Company (United States Branch), Northumberland General Insurance Company-41 Trust, Pine Top Syndicate, Professional Insurance Company of New York, Resources Insurance Company, River Plate Reinsurance Company Limited, Shamrock Casualty Company, Southeastern Casualty and Indemnity Insurance Company, Summit Insurance Company of New York, The Realex Group N.V., U.S. Risk Inc., Union Indemnity Insurance Company of New York and Whiting National Insurance Company. In his capacity as Liquidator of the Union Indemnity Insurance Company of New York, *amicus* filed a petition for certiorari in *Curiale* v. *United States*, 60 U.S.L.W. 3617 (U.S. Feb. 24, 1992) (No. 91-1347) presenting a question similar but not identical to that presented here. (Both the nature of the federal government's claims and of the state insurance statute at issue in *Curiale* are different from those at issue here.) The petition is pending.

Law, N.Y. Insurance Law § 7401, *et seq.* (McKinney 1985 and Supp. 1992). Like the Ohio insolvency statute at issue in the present case, New York's insurance insolvency law, which embodies the Uniform Insurers Liquidation Act (1939), 13 U.L.A. 328 (1986), determines among other things the priority of claims against the estate of insolvent insurance companies.

In addition to his duties as liquidator, the Superintendent of Insurance acts as rehabilitator of New York-domiciled insurance companies whose financial condition is impaired, and as ancillary receiver or conservator of insurance companies that are domiciled in other jurisdictions and are undergoing insolvency or delinquency proceedings in those jurisdictions. Altogether, as of the most recent period for which statistics are available, *amicus* as liquidator, rehabilitator, or receiver was responsible for the administration of proceedings in the New York courts involving 72 insurance companies with total reported assets of over $4.1 billion.

In all of these capacities, *amicus*' central mandate is the protection of the interests of the affected policyholders. The result sought by petitioners would dramatically reduce the funds available to pay policyholder claims.[2] A decision in petitioners' favor may also have wide-ranging implications for New York's comprehensive regulation of the business of insurance, including its complex regulatory and judicial system govern-

2 In some cases, guaranty funds established under state law may also play a role in paying the claims of policyholders of insolvent insurers. Such funds, on paying out such claims, file proofs of claim against the estates of the insolvent insurers. Because these guaranty funds are funded through assessment of solvent insurers, a decision in petitioners' favor may in some cases have an extremely broad impact, including, in the final analysis, on scarce state tax revenues, since the solvent insurer may offset such guaranty fund assessments as a credit against state taxes. *See generally Corcoran* v. *Ardra Insurance Co.*, 657 F. Supp. 1223, 1232 (S.D.N.Y. 1987) ("the [New York Property/Casualty Security] Fund, like many others, is not self-sustaining; it is crucial, therefore, to creditors of the insolvent insurer, as well as to policyholders, stockholders, and creditors of presently solvent insurers—forced to contribute to the fund—that the deficit of the insolvent insurer be reduced as much as possible"), *appeal dismissed and mandamus denied*, 842 F.2d 31 (2d Cir. 1988).

But it is well to keep in mind that life and health insurance companies write any number of insurance products the contractual obligations of which (i) exceed guaranty association limits of protection or (ii) are not accorded any protection whatsoever. The estate of the failed insurer is the only refuge for persons with claims that exceed or are not covered by guaranty association protections.

The state insurance guaranty associations represented by NCIGF and NOLHGA are part of the comprehensive system enacted by the states to handle insurance company insolvencies. All guaranty associations work closely with state officials, typically the insurance commissioner, legally responsible for the rehabilitation, conservation or liquidation of a financially impaired or insolvent insurance company. The creation of guaranty associations by the states is but one example of how insurance company insolvencies have been handled under the aegis of state law, rather than federal law. The guaranty associations act as a limited safety net in covering certain obligations of insolvent insurers to their insureds and third-party claimants. Claims not covered by a guaranty association are generally submitted directly to the insurance company in liquidation to be handled by the liquidator. In those cases where claims are paid by a guaranty association, under state insurance insolvency laws the subrogation claims of guaranty associations have the same priority as claims of insureds.[4]

As a result of the above-described state based system of resolving insurance insolvencies, the insurance company liquidator and the appropriate insurance guaranty associations are the two primary sources of protection of insureds of insolvent insurance companies. Accordingly, the various state guaranty associations have a strong involvement and interest in the present system whereby the states determine the priority of claims

[4] See, e.g., Ohio Rev. Code Ann. § 3903.42(C) (Anderson 1989).

against insolvent insurance companies as part of the general, comprehensive state-based system of regulating the business of insurance.[5]

SUMMARY OF ARGUMENT

The United States Department of the Treasury (the "Treasury Department") has filed claims of approximately $10.7 million on various bonds issued by the now insolvent American Druggists Insurance Company ("ADIC"). The Treasury Department has asserted that its claims are entitled to first priority under 31 U.S.C. 3713(a)(1)(A)[6]. The Liquidator of ADIC, George Fabe, the Superintendent of Insurance of the State of Ohio, has maintained that the federal claims are entitled to fifth priority under the Ohio Insurers Supervision, Rehabilitation, and Liquidation Act, Ohio Rev. Code Ann. § 3903.01 *et seq.* (Anderson 1989 & Supp. 1991) ("Insurers Liquidation Act"). Under the Ohio statute, claims are paid in the following order: (1) administrative expenses, (2) wage and benefit claims, (3) policyholder claims, (4) claims of general creditors, and (5) claims of federal, state and local governments. Additionally, there are three lower classes of claims. Ohio Rev. Code Ann. § 3903.42 (Anderson 1989).

Given this conflict between the federal and state laws, the Treasury Department has argued that the Ohio law is preempted by 31 U.S.C. 3713(a)(1)(A). The Liqui-

[5] Pursuant to Sup. Ct. R. 37.3, the parties' written consents to the filing of this amici curiae brief have been filed with the Clerk.

[6] 31 U.S.C. 3713(a)(1)(A) provides that:

> A claim of the United States Government shall be paid first when—
>
> (A) a person indebted to the Government is insolvent and—
>
> (i) the debtor without enough property to pay all debts makes a voluntary assignment of property;
>
> (ii) property of the debtor, if absent, is attached; or
>
> (iii) an act of bankruptcy is committed. . . .

dator has countered that preemption of the Ohio law is barred by virtue of the McCarran-Ferguson Act, 15 U.S.C. § 1011 *et seq.* That Act provides, inter alia, that "No Act of Congress shall be construed to invalidate, impair or supersede any law enacted by any State for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance." 15 U.S.C. 1012(b).

Clearly, the federal general priority statute, 31 U.S.C. 3713, is not an Act that "specifically relates to the business of insurance." Hence the core issue in this appeal is whether the Ohio law regulating insurance company insolvencies, and, specifically, prioritizing claims against insolvent insurance companies, regulates "the business of insurance." Based on both the plain meaning of the statute and this Court's prior analysis of the scope of McCarran-Ferguson, NCIGF and NOLHGA believe the Ohio insurance insolvency statute clearly regulates the business of insurance.

1. The starting point in any issue of statutory construction is the plain language of the statute itself. If the meaning of the statute is clear on its face, there is no need to proceed any further. In the present case, the issue is whether the Ohio insurance code provision establishing the relative priorities of claims against insolvent insurance companies regulates "the business of insurance." The very essence of the business of insurance is the payment of insureds when potential risks become actual claims. Since the Ohio insurance insolvency statute determines, as a practical matter, if and how much an insured (or claimant) will get paid, the Ohio law clearly regulates the business of insurance.

2. If the Court moves beyond the plain language of the statute to cases interpreting it, it will not find any of its own decisions directly on point. However, this Court has recently decided three cases interpreting the phrase "the business of insurance" which support the

conclusion that the Ohio statute is the type of regulation covered by McCarran-Ferguson. *SEC v. National Securities, Inc.*, 393 U.S. 453 (1969); *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205 (1979); *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982). The first of those cases held that the McCarran-Ferguson Act was concerned with matters such as the "relationship between insurer and insured," the "reliability" and "enforcement" of insurance policies, and the companies' "status as reliable insurers." 393 U.S. at 460. The Ohio priority statute gives a high priority to the claims of insureds against an insolvent insurance company. This increases the reliability of their policies and their ability to enforce them. This in turn enhances the relationship between the insurer and insured as set forth by *National Securities* so as to bring the Ohio priority statute under the protection of McCarran-Ferguson.

Royal Drug and *Pireno* analyzed three factors to determine if a practice by a state regulates the business of insurance:

a) "whether the practice has the effect of transferring or spreading a policyholder's risk"

b) "whether the practice is an integral part of the policy relationship between the insurer and the insured"

c) "whether the practice is limited to entities within the insurance industry"

458 U.S. at 129. The Ohio statute, which gives a high priority to insureds' claims, meets each of these three criteria. First, the priority assigned to a policyholder's claim will have a direct bearing and a major impact on whether the policyholder has in fact transferred the risk in the event his or her insurance company goes insolvent. Second, the most integral part of the policy relationship—from the point of view of the insured—is whether the insurer pays the claims it admittedly owes. The Ohio

priority scheme, which maximizes the likelihood of such payment in the event of insolvency, thus deals with a fundamental part of the relationship between the insurer and insured. Third, the Ohio Insurers Liquidation Act deals solely with the priority of claims against insurance companies. It does not attempt to regulate claims against any entities outside the insurance industry.

In sum, the Ohio Act comes within the clear meaning of the McCarran-Ferguson Act and within the meaning as analyzed by the prior decisions of this Court.

ARGUMENT

I. A STATE STATUTE WHICH PRIORITIZES CLAIMS AGAINST INSOLVENT INSURANCE COMPANIES REGULATES "THE BUSINESS OF INSURANCE" UNDER THE PLAIN MEANING OF THAT PHRASE AS USED IN THE McCARRAN-FERGUSON ACT.

The field of insurance has long been an area of dominant state concern. This Court held early on that "[i]ssuing a policy of insurance is not a transaction of commerce" *Paul v. Virginia*, 75 U.S. (8 Wall) 168, 183 (1868). It was therefore widely believed and held that insurance was not subject to federal regulation under the Commerce Clause. Thus, the Court surprised and raised great concerns within the insurance industry and the state and federal governments when it ruled in *United States v. South-Eastern Underwriters Ass'n.*, 322 U.S. 533 (1944), that insurance transactions are subject to federal regulation under the Commerce Clause in general, and the antitrust provisions of the Sherman Act in particular.

Congress reacted quickly to *South-Eastern Underwriters* by passing the McCarran-Ferguson Act, 15 U.S.C. 1011 *et seq.* That Act reflects the long-established national policy that insurance be regulated at the state level:

> Congress declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.

15 U.S.C. 1011. That general statement of policy was codified by the Congress in a specific provision which protects against preemption of state laws in this field by the federal government:

> No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance: *Provided*, That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law.[7]

15 U.S.C. 1012(b).

---

[7] It is noteworthy that unlike the Sherman Act, the Clayton Act and the Federal Trade Commission Act, the federal priority law, 31 U.S.C. 3713(a)(1)(A) was not deemed by McCarran-Ferguson to be applicable to the business of insurance, even though the federal priority statute had been enacted long before McCarran-Ferguson. Furthermore, while Congress has subsequently declared other federal laws to be applicable to the insurance industry notwithstanding McCarran-Ferguson, it has never made such a declaration about 31 U.S.C. 3713(a)(1)(A). "[T]he Sixth Circuit has established that '[v]arious statutes enacted by Congress . . . have been amended to establish federal dominance in certain areas pursuant to the McCarran-Ferguson Act. Nevertheless, 31 U.S.C. § 3173, the federal superpriority statute has not been amended to that effect.'" *Garcia v. Island Program Designer, Inc.*, No. 91-1679, 1992 WL 106774 (D. Puerto Rico, April 21, 1992) (copy included in the Appendix at 15a) (quoting the Sixth Circuit decision in the present case).

This case presents a clear conflict between state and federal law. On the one hand, Ohio and all the other states have enacted a comprehensive statutory scheme regulating insurance companies from the cradle to the grave. A significant section of that code deals with insolvent insurance companies in general and claims against them in particular. The Ohio statute prioritizes claims against these companies as follows:

(1) Administrative Expenses,

(2) Wage and Benefit Claims,

(3) Policyholder Claims,

(4) Claims of General Creditors,

(5) Claims of Federal, State and Local Governments,

(6) Late Filed Claims or Miscellaneous Claims,

(7) Surplus or Contribution Notes, and

(8) Claims of Shareholders or Other Owners.

Ohio Rev. Code Ann. § 3903.42 (Anderson 1989). Insurance codes in other states set similar priorities for claims. Federal law, by contrast, contains a general provision which grants the federal government a first priority for its claims against a debtor who has become insolvent. 31 U.S.C. 3713. This statute does not relate to insurance companies in particular.

Normally in a situation such as this, the Commerce and Supremacy Clauses of the U.S. Constitution would require that the state law be preempted by the federal law. However, as noted earlier, Congress has expressly barred the doctrine of preemption from applying to state laws regulating the business of insurance unless the federal law at issue "specifically relates to the business of insurance." In the present case, there is no question that 31 U.S.C. 3713 does not relate specifically to the business of insurance. Its terms speak generally to cases where someone indebted to the United States has become

insolvent; the federal law does not mention or refer to insurance companies in any way. Thus, the present dispute turns on the question of whether the Ohio statute prioritizing claims against insolvent insurance companies regulates the business of insurance.

In deciding whether the Ohio law regulates the business of insurance, the threshold consideration is the language of the McCarran-Ferguson Act itself. *Pennsylvania Public Welfare Dept. v. Davenport*, 495 U.S. 552, 557-558 (1990) ("Our construction . . . is guided by the fundamental canon that statutory interpretation begins with the language of the statute itself."); *Mallard v. U.S. Dist. Court for Southern Dist. of Iowa*, 490 U.S. 296, 300 (1989) ("Interpretation of a statute must begin with the statute's language."); *St. Paul Fire & Marine Ins. Co. v. Barry*, 438 U.S. 531, 541 (1978). If the meaning of that language is clear and plainly applies to the Ohio law, then there is no need for any additional analysis. *Freytag v. Commissioner of Internal Revenue*, 111 S. Ct. 2631, 2636 (1991) ("When we find the terms of a statute unambiguous, judicial inquiry should be complete except in rare and exceptional circumstances."); *Burlington Northern R. Co. v. Oklahoma Tax Comm'n*, 481 U.S. 454, 461 (1987). In this case, the Ohio provision at issue falls within the clear and plain meaning of the phrase "the business of insurance."

Ohio Rev. Code Ann. § 3903.42 is part of a comprehensive state statute regulating all aspects of the business of insurance. See Ohio Rev. Code Ann. Title 39 (Anderson 1989 & Supp. 1991). This comprehensive regulation of the insurance industry by the State of Ohio is typical of what is found in the other states as well. The regulation of insurance company insolvencies (Ohio Rev. Code Ann. Chapter 3903) is simply one part of this overall statutory scheme. It involves, *inter alia*, the appointment of a liquidator to marshall all the assets of the insurance company and the adjustment and payment of

claims against the insurance company. The insurance company is operated by the liquidator in most respects as an ongoing company, the primary exception being that it no longer takes on any new business during the liquidation proceedings. In other words, while the insolvency proceedings are pending, the insurance company continues to conduct most aspects of the business of insurance other than the solicitation of new customers and the issuance of new policies. For example, the liquidator may, and does, employ employees and agents;[8] conduct "the business . . . of the insurer;"[9] continue to prosecute and to commence in the name of the insurer any and all suits or legal proceedings;[10] enforce reinsurance contracts;[11] and collect unpaid earned premiums from any person.[12] The statutory scheme regulating insolvent insurance companies in Ohio is typical of the framework set up in the other states under the NAIC's Insurers Rehabilitation and Liquidation Model Act (1991).[13]

All of the regulations established by the Ohio statute, including the priority scheme, are designed to see that the *raison d'etre* of insurance—the payment of insureds' claims—in fact occurs:

> Up until the time there is a claim and a payment is made, the only tangible evidence of insurance is a piece of paper. In other words, the real product of insurance is the claims proceeds. Selection of the prospect, qualifying him for coverage that suits his needs, delivery of a policy, collecting premiums for perhaps years, making changes in coverage to meet changing situations, all of these are but preambles to the one purpose for which the insurance was secured, namely to collect dollars if and when an unforeseen event takes place.

J. Wickman, *Evaluating the Health Insurance Risks*, 57 (1965). Thus, the state priority scheme falls within the plain and commonly understood meaning of the phrase "the business of insurance." It is the business of insurance to pay claims when a possible risk has blossomed into an actual claim. That act, more than any other act in the field of insurance, is what is commonly understood to be the business of insurance. Ohio Rev. Code Ann. § 3903.42 insures that the commonly understood meaning of the most basic business of insurance is a reality, even in those instances when an insurance company has become insolvent. As such, it is well within the meaning of the phrase "the business of insurance," if in fact not at the very core of that phrase. Accordingly, the McCarran-Ferguson Act dictates that the Ohio statute is not preempted and that Ohio law controls the disposition of all claims against American Druggist Insurance Company.

II. A STATE STATUTE WHICH PRIORITIZES CLAIMS AGAINST INSOLVENT INSURANCE COMPANIES REGULATES "THE BUSINESS OF INSURANCE" AS THAT PHRASE HAS BEEN INTERPRETED IN PRIOR SUPREME COURT CASES INVOLVING THE McCARRAN-FERGUSON ACT.

While this case presents an issue of first impression for this Court,[14] the Court has previously analyzed the

---

[8] Ohio Rev. Code Ann. § 3903.21(A)(2) and (3) (Anderson 1989).

[9] Ohio Rev. Code Ann. § 3903.21(A)(4) (Anderson 1989).

[10] Ohio Rev. Code Ann. § 3903.21(A)(12) (Anderson 1989).

[11] Ohio Rev. Code Ann. § 3903.32 (Anderson 1989).

[12] Ohio Rev. Code Ann. § 3903.33 (Anderson 1989).

[13] Section 42 of the Model Act deals with the priority of claims against insolvent insurance companies. See also Uniform Insurers Liquidation Act §§ 6-8, 13 U.L.A. 321-353 (1986).

[14] Five federal court cases have addressed the specific issue now before the Court. The first two cases to decide this issue ruled that prioritizing claims against an insolvent insurance company did not constitute the business of insurance. *Gordon v. United States Dep't. of the Treasury*, 846 F.2d 272 (4th Cir.), *cert. denied*, 488 U.S. 954 (1988); *Idaho ex rel. Soward v. United States*, 858 F.2d 445 (9th

meaning of "the business of insurance" in other contexts. Although none of those cases were analogous to the present appeal the general language and analysis contained in three such cases supports respondent's position that McCarran-Ferguson includes within its scope the type of state statute at issue here.

In *SEC v. National Securities, Inc.*, 393 U.S. 453 (1969), the SEC attempted to enjoin violations of Section 10(b) of the Securities Exchange Act and Rule 10(b)-5 in connection with misrepresentations and omissions in communications by National Securities to shareholders of Producers Life Insurance Co. National Securities was proposing to merge Producers with an insurance company controlled by National Securities. After the SEC was denied temporary injunctive relief, the shareholders of Producers approved the merger. Pursuant to state law, the Arizona Director of Insurance found that the merger was not inequitable to Producer's shareholders and not otherwise contrary to law, and the merger was consummated. 393 U.S. at 457. The SEC thereafter amended its complaint seeking to unwind the merger. National Securities argued that since the merger had been approved by the State Director of Insurance pursuant to state law, McCarran-Ferguson barred the SEC's attempt to use the Securities Exchange Act to unwind the merger. The issue thus presented to the Court was whether the

Cir. 1988), *cert. denied*, 490 U.S. 1065 (1989). Subsequent to those two decisions, the Sixth Circuit created a conflict among the circuits by its decision in the present case. Since the Sixth Circuit decision herein, two United States District Courts have relied upon that decision in holding that the state/commonwealth priority statutes for insolvent insurance companies regulated the business of insurance and therefore came within the protection of McCarran-Ferguson. *Garcia v. Island Program Designer, Inc.* No. 91-1679, 1992 WL 106774 (D. Puerto Rico, April 21, 1992) (hereinafter "*Garcia*"); *Lyons v. United States*, No. 4-91-10209 (S.D. Iowa, July 2, 1992) (hereinafter "*Lyons*") (copy included in the Appendix at 8a).

Arizona statute was a "law enacted . . . for the purpose of regulating the business of insurance." 393 U.S. at 457. This Court held that "[w]e do not believe that a state statute aimed at protecting the interests of those who own stock in insurance companies comes within the sweep of the McCarran-Ferguson Act." 393 U.S. at 457. The Court found that McCarran-Ferguson addressed concerns such as the "relationship between insurer and insured," the "reliability" and "enforcement" of insurance policies, and the companies' "status as reliable insurers." 393 U.S. at 460. By contrast:

> [A]rizona is concerning itself with a markedly different set of problems. It is attempting to regulate not the "insurance" relationship, but the relationship between a stockholder and the company in which he owns stock. This is not insurance regulation, but securities regulation. . . . The crucial point is that here the State has focused its attention on stockholder protection; it is not attempting to secure the interests of those purchasing insurance policies. Such regulation is not within the scope of the McCarran-Ferguson Act.

393 U.S. at 460.

Unlike the Arizona statute, Ohio Rev. Code Ann. § 3903.42 protects the insureds of insolvent insurance companies—not their shareholders. Insureds' claims are given a high priority—above those of general creditors, federal, state and local governments, late claims, miscellaneous claims, surplus or contribution notes and "claims of shareholders or other owners." Ohio Rev. Code Ann. § 3903.42 (Anderson 1989). As *Lyons* said of the comparable Iowa statute:

> The focus of the McCarran-Ferguson Act is on protecting policyholders. . . . [citing *National Securities*] The Sixth Circuit in *Fabe*, observed that "it is clear from the language and operation of [Ohio's Insolvent Insurer's statute] that its focus is the protection of

> insureds by diverting the scarce resources of the liquidated entity away from any non-insured creditors, toward policyholders." Iowa's insolvent insurer's statute is similarly focused.

Lyons at p. 13a. Thus, in protecting the policyholders of insolvent insurance companies, the Ohio statute has precisely the intent required by *National Securities*.

Additionally, unlike *National Securities*, the present case does not involve a party trying to invoke McCarran-Ferguson to evade liability for violations of federal law. The present suit is brought by the Liquidator of ADIC to maximize the assets available to insureds in the face of attempts by the federal government to jump ahead in line and thereby jeopardize whether the insureds will collect from their insurance company. If the Court accepts the position of the United States, the insureds will ultimately recover less than if the position of the Liquidator is upheld. Thus, consistent with the directive of *National Securities*, and unlike the state statute in that case, the Ohio law is designed to protect the interests of insureds.

The Court next visited the issue of the scope of "the business of insurance" in *Group Life & Health Insurance Co. v. Royal Drug Co.*, 440 U.S. 205 (1979). That case involved a Sherman Act claim against a Blue Shield insurance company in Texas. The suit claimed that contractual agreements Blue Shield had with pharmacies throughout the state of Texas violated § 1 of the Sherman Act by fixing the retail prices of drugs and causing some of Blue Shield's policyholders to boycott certain pharmacies that did not participate in the Blue Cross Pharmacy Agreements. 440 U.S. at 207. The issue before the Court was "[w]hether the Court of Appeals was correct in concluding that these Pharmacy Agreements are not the "business of insurance" within the meaning of § 2(b) of the McCarran-Ferguson Act." 440 U.S. at 210. The Court reasoned that the Pharmacy Agreements had nothing to do with the spreading of a policyholder's risk,

but were merely contractual arrangements to help minimize the cost of meeting its promises to its policyholders. As the Court noted, "so long as that promise is kept, policyholders are basically unconcerned with arrangements made with Blue Shield and participating pharmacies." 440 U.S. at 214. The Court also noted that the Pharmacy Agreements were not between the insurer and the insured, but were, instead, "separate contractual arrangements between Blue Shield and pharmacies engaged in the sale and distribution of goods and services other than insurance." 440 U.S. at 216. Finally, the Court thought it was significant that the Pharmacy Agreements involved parties "wholly outside the insurance industry." 440 U.S. at 231.

In contrast to *Royal Drug*, the present case impacts directly on whether the ADIC insureds successfully transferred their risks to an insurer as they intended when they entered into their insurance contract, or whether the full brunt of that risk is going to land on their shoulders due to the insolvency of ADIC. Unlike *Royal Drug*, this is clearly not a case where the "policyholders are basically unconcerned" with the operation of the Ohio insurance insolvency statute. Policyholders are vitally concerned with whether the Ohio statute operates as written to maximize the chance their claims will be paid. Second, the Ohio statute focuses directly on the enforcement of the insurance contract between insurer and insured, rather than an organized series of contracts with third party pharmacies. Third, the State Insurance Insolvency Statute prioritizes claims only against insurance companies, not against parties "wholly outside the insurance industry." 440 U.S. at 231.

Finally, unlike *Royal Drug*, the present case does not involve an attempt to use McCarran-Ferguson to circumvent the requirements of the Sherman Act. This was precisely the point upon which the Court in *Garcia* distinguished *National Securities*, *Royal Drug* and *Pireno*:

alleged anti-competitive practices affected insurance costs and therefore "the risk that the insurer would be unable to pay claims" (presumably, by forcing the insurer out of business). Pet. Br. at 20. In addition to being far-fetched, petitioners' argument misses the point. The activities in *Royal Drug* and *Pireno* were not an integral part of the insurer-insured relationship because they were designed only to strengthen the insurers' market share at the expense of competitors, a purpose completely independent of the policyholders' interests. The Ohio statute, to the contrary, goes to the heart of the insurance relationship by helping ensure that the policyholder will get what he or she contracted for: reimbursement of insurance claims.

Petitioners also argue that the statute is not an integral part of the insurance relationship because during liquidation "there is no longer a relationship between the policyholder [*sic*]." Pet. Br. at 20. Again, the flaw in this argument is that the insurance company does not disappear upon entry of an order of liquidation. Although an order of liquidation may signal the impending demise of the insurer, the insurer-insured relationship continues during liquidation: insureds continue to make claims against the insurer; the liquidator, on behalf of the insurer, continues to adjust those claims; and the insurance company through the liquidator continues to pay legitimate claims to the extent there are funds available. Payment of claims by the insurer " 'brings the insurance contract "to life" in a fashion far more vivid than does any other single act in connection with the purchase, issuance, and maintenance of the contract.' " *Pireno*, 458 U.S. at 137 n.2 (Rehnquist, J., dissenting) (quoting Butler, "Loss Adjustment in Fire Insurance," in *Property and Liability Insurance Handbook* 219 (J. Long & D. Gregg eds. (1965)). Thus, contrary to petitioners' assertions, the Ohio statute's priority scheme is indeed an integral part of the insurer-insured relationship.

c. The Act's priority scheme focuses primarily on the insurer and the insured

This Court has made clear that, to satisfy this third criterion, an insurance activity need not be limited exclusively to entities within the insurance industry. "[T]he challenged [ ] practices need not be denied the [McCarran-Ferguson] exemption *solely* because they involve parties outside the insurance industry." *Pireno*, 458 U.S. at 133 (emphasis in original). Rather, in *Royal Drug* and *Pireno*, the Court focused on the importance and degree of participation of outside entities in the challenged insurance practice.

The alleged price-fixing measures in *Royal Drug* and the peer review process in *Pireno* both involved intentional arrangements by insurers for affirmative participation by third parties, who were essential to achieving the insurers' goals of strengthening their market position. Unlike these practices, the Ohio Insurers Supervision Act does not require, and does not seek, any sort of active participation by entities outside the insurance industry. Indeed, outside parties are "involved" in the Ohio statute only by negative implication: prioritizing necessarily means placing one class of claims before another.

The Ohio statute satisfies the third *Pireno* criterion because it is directed first and foremost to the two entities that form the cornerstone of the insurance industry: the insurer and the insured. Incidental implication of third parties is not sufficient to take the Ohio statute outside the definition of "regulation of the business of insurance."

That a state insurance liquidation statute may rank certain classes of claims ahead of policyholders' claims does not alter this conclusion. As the court below found, the "focus is the protection of insureds by diverting the scarce resources of the liquidated entity away from any non-insured creditors, toward policyholders." *Fabe*, 939 F.2d at 352. The goal remains protection of the policyholders. Due to the insolvent insurer's limited funds, allowing the government to leapfrog ahead would often result in the policyholders receiving nothing, thus frustrating the goal of insurance liquidation statutes.

In sum, the court below correctly held that the Ohio statute satisfies all three of the *Royal Drug/Pireno* requirements for determining whether the statute "regulates the business of insurance." Therefore, pursuant to McCarran-Ferguson, state law governs here so that policyholders—the class that state insurance liquidation statutes were enacted to protect—will have priority when claiming against insolvent insurers.[14]

B. The Legislative History Of McCarran-Ferguson, If Relevant At All, Supports The Conclusion That State Insurance Statutes And Not The Federal Priority Statute Must Determine The Priority Of The Distribution Of Assets Of Insolvent Insurers

Petitioners also argue that this Court should look to what they refer to as the "enactment history" of McCarran-Ferguson to determine the scope of the term the "business of insurance." Pet. Br. at 22. They suggest that examination of such history supports the notion that McCarran-Ferguson merely served to restore the *status quo* that existed prior to *United States* v. *South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944), the decision of this Court that prompted enactment of McCarran-Ferguson. Pet. Br. at 23. Under this *status quo*, they argue, the question presented here had already been decided in favor of the Federal Priority Statute in cases like *United States* v. *Knott*, 298 U.S. 544 (1936), and thus McCarran-Ferguson is, notwith-

14 A contrary determination would not only harm policyholders, but would also disrupt other aspects of state regulation of insolvent insurers. The federal and state courts of New York have made it clear, for instance, that under McCarran-Ferguson, New York insurance insolvency law, *see Knickerbocker Agency, Inc.* v. *Holz*, 4 N.Y.2d 245, 149 N.E.2d 885, 173 N.Y.S.2d 602 (1958), and not the Federal Arbitration Act, 9 U.S.C. §§ 1 *et seq.* (1988 & Supp. II 1990), governs the arbitrability of claims involving insolvent New York insurers. *See Washburn* v. *Corcoran*, *supra*, 643 F. Supp. at 556; *Corcoran* v. *Ardra Insurance Co.*, 156 A.D.2d 70, 553 N.Y.S.2d 695 (1st Dep't), *aff'd*, 77 N.Y.2d 225, 567 N.E.2d 969, 566 N.Y.S.2d 575 (1990), *cert. denied*, 111 S. Ct. 2260 (1991). A determination by this Court that one aspect of a state insurance liquidation system is not regulation of the "business of insurance" may cast doubt on this and other long-standing state policies.

standing its plain terms, of no effect in this case (and, by implication, in any other case where a conflict between a federal statute of general application and a state insurance statute had been decided prior to McCarran-Ferguson's enactment).

There are three flaws in this argument. First, the actual text of McCarran-Ferguson says nothing about a return to the pre-*South-Eastern Underwriters status quo*. Instead, it states quite unambiguously that "*No* Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance. . . ." 15 U.S.C. § 1012(b) (emphasis added). Congress made no exception for federal statutes enacted "in the earliest days of the Republic," Pet. Br. at 6; neither did it except statutes that, prior to enactment of McCarran-Ferguson, had been ruled to govern notwithstanding contrary state law under familiar principles of federal constitutional supremacy.

Second, McCarran-Ferguson's legislative history indicates that Congress intended to do far more than simply "overrule" *South-Eastern Underwriters*. Indeed, as Justice Powell recognized in his partial concurrence in *Arizona Governing Committee* v. *Norris*, 463 U.S. 1073, 1099-1100 n.5 (1983), Congress rejected a version of McCarran-Ferguson which would have merely overturned the holding of *South-Eastern Underwriters* and opted instead for the current, broader law. The legislative history provides extensive support for this unstrained reading of the statute. *See, e.g.*, 91 Cong. Rec. 483 (1945) (Remarks of Sen. Radcliffe) ("It is unnecessary and unwise to create any doubt as to the right of the States to go ahead and function freely in the handling of insurance."); 91 Cong. Rec. 487 (1945) (Remarks of Sen. Wherry) ("[McCarran-Ferguson] would put the regulation of the insurance business in the hands of the States. That is the important thing in this bill."). *See also Prudential Insurance Co.* v. *Benjamin*, *supra*, 328 U.S. at 429 (McCarran-Ferguson drafted "broadly to give support to the existing *and future* state systems for regulating and taxing the business of insurance" (emphasis added)).

Third, even if *Knott* and similar cases were relevant here, they did not squarely rule on a conflict between statutes such as those presently at issue. In *Knott*, for instance, this Court considered a state statute that "contained only generalized provisions protecting domestic creditors in Florida insurance companies over foreign creditors." *Fabe*, 939 F.2d at 348. As the court below correctly held, such a statute "in no way regulated the 'business of insurance' for the protection of the insured." *Id.* The holding in *Knott*, then, even if it could be said to have survived the enactment of McCarran-Ferguson, is of no effect here.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted,

Mathias E. Mone
Counsel of Record
Adam Liptak
James R. Oswald
CAHILL GORDON & REINDEL
(a partnership including a
professional corporation)
80 Pine Street
New York, New York 10005
(212) 701-3000

William F. Jerome
State of New York
Insurance Department
Liquidation Bureau
123 William Street
New York, New York 10038

Dated: September 8, 1992

No. 91-1513

In The

Supreme Court of the United States

October Term, 1992

United States Department of the Treasury and Mitchell A. Levine, Assistant Commissioner,
Petitioners,

v.

George Fabe, Superintendent of Insurance, State of Ohio,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

---

BRIEF OF THE COUNCIL OF STATE GOVERNMENTS, NATIONAL CONFERENCE OF STATE LEGISLATURES, NATIONAL GOVERNORS' ASSOCIATION, INTERNATIONAL CITY/COUNTY MANAGEMENT ASSOCIATION, NATIONAL ASSOCIATION OF COUNTIES, U.S. CONFERENCE OF MAYORS, NATIONAL INSTITUTE OF MUNICIPAL LAW OFFICERS, AND NATIONAL LEAGUE OF CITIES AS *AMICI CURIAE* IN SUPPORT OF RESPONDENT

Michael J. Wahoske
Daniel P. O'Keefe
John B. Orenstein
Catherine A. Gnatek
Dorsey & Whitney
2200 First Bank Place East
Minneapolis, Minnesota 55402
(612) 340-2600
Of Counsel

Richard Ruda *
Chief Counsel
James I. Crowley
State and Local Legal Center
444 N. Capitol Street, N.W.
Suite 345
Washington, D.C. 20001
(202) 434-4850

* *Counsel of Record for the* Amici Curiae

Wilson - Epes Printing Co., Inc. - 789-0096 - Washington, D.C. 20001

QUESTION PRESENTED

Whether Ohio Rev. Code § 3903.42, which establishes the priority of claims in insurance company liquidations, regulates the "business of insurance" within the meaning of the McCarran-Ferguson Act, 15 U.S.C. § 1012.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

TABLE OF AUTHORITIES—Continued

TABLE OF AUTHORITIES—Continued

Other Authorities

TABLE OF AUTHORITIES—Continued

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

No. 91-1513

UNITED STATES DEPARTMENT OF THE TREASURY and MITCHELL A. LEVINE, ASSISTANT COMMISSIONER,

Petitioners,

v.

GEORGE FABE, SUPERINTENDENT OF INSURANCE, STATE OF OHIO,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

---

BRIEF OF THE COUNCIL OF STATE GOVERNMENTS, NATIONAL CONFERENCE OF STATE LEGISLATURES, NATIONAL GOVERNORS' ASSOCIATION, INTERNATIONAL CITY/COUNTY MANAGEMENT ASSOCIATION, NATIONAL ASSOCIATION OF COUNTIES, U.S. CONFERENCE OF MAYORS, NATIONAL INSTITUTE OF MUNICIPAL LAW OFFICERS, AND NATIONAL LEAGUE OF CITIES AS *AMICI CURIAE* IN SUPPORT OF RESPONDENT

INTEREST OF THE *AMICI CURIAE*

Amici, organizations whose members include state, county and municipal governments and officials throughout the United States, have a compelling in-

terest in legal issues that affect state and local governments. This case presents a question of state regulatory authority of utmost importance to *amici:* whether carefully crafted state statutory schemes designed to protect policyholders in insurance company liquidations are to be subverted by the federal "superpriority" statute.

The importance of this issue to *amici* is demonstrated by the fact that more than twenty-five States have priority statutes that, like the Ohio statute here, place policyholder claims ahead of federal, state, and local government claims. *See* NAIC Model Regulation Service 555-39 - 555-42 (Jan. 1992). *See also* Br. *Am. Cur.* of National Association of Insurance Commissioners *Gordon v. United States*, No. 88-302 (U.S.) (brief filed Sept. 1988), Appendix D (collecting laws of 35 States that confer a higher priority on policyholder claims than federal government claims). The interests of millions of policyholders are directly at stake.

Because of the importance of this case to *amici* and their citizens, *amici* submit this brief to assist the Court in its resolution of the case.[1]

STATEMENT OF THE CASE

This case arises out of the liquidation of the American Druggists' Insurance Company pursuant to Chapter 3903 of the Ohio Revised Code. Section 3903.42 priorities claims in insurance company liquidations. It grants first and second priority to costs of administering the liquidation and salary claims of nonexecutive employees (limited to $1,000 per employee). Ohio Rev. Code § 3903.42(A), (B). Following these traditional priorities[2]—which are necessary to fund the administration of the estate and provide limited compensation to employees—priority is then granted to "claims under policies for losses incurred." *Id.* § 3903.42(C). Ranked behind those are "[c]laims of general creditors," and behind general creditors are "[c]laims of the federal or any state or local government." *Id.* § 3903.42(D), (E).

In the ADIC liquidation, the United States filed over $10.7 million in claims based on immigration, appearance, performance and payment bonds and sought first priority under the federal superpriority statute, 31 U.S.C. § 3713(a)(1)(A). Pet. Br. 2. Thereafter, respondent George Fabe, Superintendent of Insurance of the State of Ohio, sought a declaratory judgment in federal district court that Ohio Rev. Code § 3903.42 is a regulation of the "business of insurance" under section 2 of the McCarran-Ferguson Act, 15 U.S.C. § 1012, and that the United States' claims were subject to the Ohio statute. The district court held that § 3903.42 does not regulate the "business of insurance" and that accordingly the federal superpriority statute preempted Ohio law. Pet. App. 44a-45a.

The court of appeals reversed. Relying principally on the three-factor test of *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982), the court held that Ohio's prioritization of the United States' claim was "a state regulation which protects the interests of the insured, and therefore is protected from federal preemption as a law regulating the 'business of in-

[1] The parties' letters of consent have been filed with the Clerk pursuant to Rule 37.3 of the Court.

[2] *See* 11 U.S.C. § 507(a) (conferring favored priority on costs of administration and employee claims).

surance.'" Pet. App. 20a.[3] In the court of appeals' view, the Ohio statute satisfies the *Pireno* factors because it

> (1) transfers the policyholders risk of loss by insolvency at the time of contracting, (2) is an integral part of the relationship between insurer and insured, and (3) is exclusive in its operation to entities within the insurance industry.

Id. at 21a.[4]

SUMMARY OF ARGUMENT

The McCarran-Ferguson Act expressly preserves the "business of insurance" as a subject of state regulation. 15 U.S.C. § 1012(a). The Act provides that no general federal legislation "shall be construed to invalidate, impair or supersede any law enacted by any State for the purpose of regulating the business of insurance." 15 U.S.C. § 1012(b). Both the plain meaning of McCarran-Ferguson and the understanding of the enacting Congress demonstrate that Ohio Rev. Code § 3903.42 regulates the

[3] The parties have stipulated that the state priority provisions regulate the insurance industry, that application of the superpriority statute would "invalidate, impair, or supersede" the state provisions, and that the federal superpriority statute does not specifically relate to the business of insurance. Pet. App. 3a.

[4] The United States argued below that "even if the Ohio statute governs the priority of claims of the United States, the [federal] government's claims are entitled to third priority under the Ohio statute as policyholder's claims." Pet. Br. 11 n.4. This issue of state law was not addressed by the courts below, *id.*, and should not be addressed by this Court. *See EEOC v. FLRA*, ~~476~~ U.S. 19, 24 (1986); *Burford v. Sun Oil Co.*, 319 U.S. 315 (1943).

"business of insurance" and is not preempted by the federal superpriority statute.

A. The core of insurance is an undertaking by the insurer "to indemnify or guarantee another against loss by a certain specified contingency or peril." *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205, 211 n.7 (1979) (citation omitted). Obviously central to the "business of insurance" is payment of the insured's claim in the event such a loss occurs. "The key representation of the insurance company and the principal expectation of the policyholder is that prompt payment will be made when the event insured against actually occurs." *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, 136 (1982) (Rehnquist, J., dissenting).

The purpose of state regulation of the "business of insurance" is to ensure that policyholders get what they bargained for. Ohio, like most States, has adopted a comprehensive regulatory scheme that preserves insurer solvency in order to protect policyholders. State regulation of the "business of insurance" does not end when an insurer becomes insolvent. The State's overriding purpose—the protection of policyholders—is no less great. Ohio Rev. Code § 3903.42 is thus an integral part of the State's comprehensive regulation of the "business of insurance."

B. This conclusion is underscored by the fact that at the time McCarran-Ferguson was enacted, the power of the States to regulate insurer insolvencies was long established. The regulation of insurance "has traditionally been under the control of the states." *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65, 69 (1959). Congress enacted McCarran-Ferguson to "broadly . . . give support to

the existing and future state systems for regulating and taxing the business of insurance." *SEC v. National Securities, Inc.*, 393 U.S. 453, 458 (1969) (citation omitted). Such state regulation was understood by Congress to encompass regulation of all aspects of "the relationship between the insurance company and the policyholder." *Id.* at 460. "The relationship between insurer and insured, the type of policy which could be issued, its *reliability*, interpretation, and *enforcement*—these were the core of the 'business of insurance'" as understood by Congress when it enacted McCarran-Ferguson. *Id.* (emphasis added). Ohio's grant of priority to the claims of policyholders epitomizes the State's concern for the "reliability" and "enforcement" of insurance policies.

C. Under this Court's analysis in *National Securities*, the Ohio statute regulates the "business of insurance" because it is an "attempt[] to secure the interests of those purchasing policies" and protects "the security of and service to be rendered to policyholders." 393 U.S. at 460, 462. The criteria advanced by this Court in construing the scope of McCarran-Ferguson's antitrust exemption in *Pireno* and *Royal Drug* are inapplicable here because they focus solely on the "business practices" of insurers, not on the expectations of policyholders. Both *Pireno* and *Royal Drug* recognize, however, that payment of policyholders' claims is at the "core of the 'business of insurance.'" *Pireno*, 458 U.S. at 128; *Royal Drug*, 440 U.S. at 215-16. The United States' reliance on these criteria ignores the fundamental purpose of insurance, the broad authority Congress gave the States to regulate the "business of insurance," and the limited scope of McCarran-Ferguson's antitrust exemption.

ARGUMENT

OHIO REV. CODE § 3903.42 REGULATES THE "BUSINESS OF INSURANCE" WITHIN THE MEANING OF THE McCARRAN-FERGUSON ACT.

A. Ohio's Policyholder Priority Statute Regulates the "Business of Insurance" in the Ordinary Sense of Those Words.

The McCarran-Ferguson Act provides that "[t]he business of insurance . . . shall be subject to the laws of the several States which relate to the regulation or taxation of such business," 15 U.S.C. § 1012(a), and that no general federal legislation "shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance." 15 U.S.C. § 1012(b). In order to determine whether Ohio Rev. Code § 3903.42 is saved from preemption by McCarran-Ferguson, the Court must decide whether it has "the purpose of regulating" the "business of insurance."

The answer to this inquiry is clear. The payment of policyholders' claims in the event of loss or injury is at the core of the "business of insurance." State regulation of the payment of claims in insolvency—including laws that establish favored priority for policyholders' claims—accordingly protects the fundamental interests of policyholders by ensuring that this core purpose of insurance is achieved.

1. *The "Business of Insurance" Is, Above All, the Business of Paying Insureds in the Event of Loss.*

"[T]he starting point in a case involving construction of the McCarran-Ferguson Act, like the starting point in any case involving the meaning of a statute, is the language of the statute itself." *Royal Drug*, 440 U.S. at 210. In this case the controlling language is "business of insurance."

The pertinent principles are well settled. An insurance contract is one "by which one party . . . promises to make a certain payment of money upon the destruction or injury of something in which the other party has an interest." 1 Couch on Insurance 2d § 1.2 at 4-5 (rev. ed. 1984). The insurance company, in other words, "undertakes to indemnify or guarantee another against loss by a certain specified contingency or peril." *Royal Drug*, 440 U.S. at 211 n.7 (citation omitted). *See* Black's Law Dictionary 802 (6th ed. 1990) (insurance is "[a] contract whereby, for a stipulated consideration, one party undertakes to compensate the other for loss on a specified subject by specified perils"); American Heritage Dictionary 667 (2d ed. 1982) (insurance is "[c]overage by a contract binding a party to indemnify another against specified loss in return for premiums paid"); Webster's New Collegiate Dictionary 600 (1977) (insurance is "coverage by contract whereby one party undertakes to indemnify or guarantee another against loss by a specified contingency or peril").[5]

---

[5] *See also Comm'r of Internal Revenue v. W.H. Luquire Burial Ass'n Co.*, 102 F.2d 89, 90 (5th Cir. 1939); *Cal. Physicians' Serv. v. Garrison*, 28 Cal. 2d 790, 172 P.2d 4, 13 (1946); *Benevolent Burial Ass'n v. Harrison*, 181 Ga. 230, 181 S.E. 829, 833 (1935); *People ex rel. Kasson v. Rose*,

Central to the business of insurance is payment of claims in the event the losses insured against occur. "The key representation of the insurance company and the principal expectation of the policyholder is that prompt payment will be made when the event insured against actually occurs." *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, 136 (1982) (Rehnquist, J., dissenting).

> "Up until the time there is a claim and a payment is made, the only tangible evidence of insurance is a piece of paper. In other words, *the real product of insurance is the claims proceeds.* Selection of the prospect, qualifying him for coverage that suits his needs, delivery of a policy, collecting premiums for perhaps years, making changes in coverage to meet changing situations, all of these are but preambles to *the one purpose for which the insurance was secured, namely to collect dollars if and when an unforeseen event takes place.*"

Id. at 136-37 (quoting J. Wickman, *Evaluating the Health Insurance Risk* 57 (1965)) (emphasis added). *See also* Butler, *Loss Adjustment in Fire Insurance, in* Property and Liability Insurance Handbook 219 (J. Long & D. Gregg eds. 1965) ("The adjustment (including payment) of claims represents the final

---

174 Ill. 310, 51 N.E. 246, 246-47 (1898); *Aetna Ins. Co. v. Great Amer. Indem. Co.*, 124 So. 2d 626, 628 (La. App. 1960); *Associated Hosp. Serv. v. Mahoney*, 161 Me. 391, 213 A.2d 712, 721 (1965); *Chicago Bonding & Ins. Co. v. Oliner*, 139 Md. 408, 115 A. 592, 593 (1921); *Gregg v. Comm'r of Corporations and Taxation*, 315 Mass. 704, 54 N.E.2d 169, 172 (1944); *State ex rel. Duffy v. W. Auto Supply Co.*, 134 Ohio St. 163, 16 N.E.2d 256, 258 (1938); *Young v. Stephenson*, 82 Okla. 239, 200 P. 225, 227 (1921); *Nat'l Auto Serv. Corp. v. State*, 55 S.W.2d 209, 210-11 (Tex. Civ. App. 1932).

act in the insurance process. The payment of a claim by an insurance company brings the insurance contract 'to life' in a fashion far more vivid than does any other single act in connection with the purpose, issuance, and maintenance of the contract."), *quoted in Pireno*, 458 U.S. at 137 n.2 (Rehnquist, J., dissenting); C. Cissley, Claim Administration: Principles and Practices iii (1980) ("Claim administration is the last link in the process of insurance. . . . Indeed, it is the claim administration function that delivers on the product sold to the policyowner."), *quoted in Pireno*, 458 U.S. at 137 n.2 (Rehnquist, J., dissenting).[6]

2. *The Purpose of the Policyholder Priority Statute, and of the Regulatory Scheme of Which It Is a Part, Is to Make Certain Policyholders Are Paid.*

A. The primary purpose of state regulation of the "business of insurance" is to ensure that policyholders get what they bargained for: the insurer's payment on the policy in the event of loss. *See* Dingell Report at 1 ("An insurer's ability to pay—its solvency—must be subjected to proper regulation on a continuing basis, from the time premium payments are accepted until the time all anticipated insured events have occurred. The policyholder must rely on the

[6] As a recent, authoritative House report explains,

> When an insurer wrongfully fails to honor its promise to pay, the whole concept of insurance . . . fails. . . . The expectation that an insurance company will be around to pay legitimate claims is the first and most basic consumer right of every policyholder.

Staff of House Comm. on Energy and Commerce, 101st Cong., 2d Sess., *Failed Promises: Insurance Company Insolvencies* 1 (Comm. Print 1990) (hereinafter "Dingell Report").

competence of the regulatory system . . . for protection from insolvency.").

To accomplish this purpose, Ohio, like many States, *see NAIC Model Regulation Service* 555-39 - 555-42 (Jan. 1992), has adopted a comprehensive regulatory scheme designed to protect policyholders by empowering the superintendent of insurance to scrutinize closely insurers' finances on a continuing basis.[7]

[7] At the licensing stage, the Ohio superintendent of insurance has broad authority to examine the financial affairs of an insurer: if a license is issued, the superintendent must conduct audits every three to five years, and may conduct them more often if necessary. Ohio Rev. Code § 3901.07(B). All domestic insurers must meet minimum capital and surplus requirements. *Id.* §§ 3907.05 (life insurers), 3929.011 (other insurers). A licensed insurer that falls below state capital requirements may be prohibited "from issuing any new policies" as well as transacting any other business. *Id.* § 3901.10. Life insurers must deposit securities with the superintendent, who holds them "as security for policyholders in the company." *Id.* § 3907.07. All other companies are required to maintain minimum reserves in an amount "estimated to be sufficient to provide for the ultimate payment of all losses or claims, whether reported or unreported, for which the company may be liable." *Id.* § 3929.012. All insurers are required to file annual reports detailing their financial condition so that compliance with these requirements can be determined by state regulators. *Id.* §§ 3907.19, 3929.30. Only those insurers licensed in Ohio can sell policies within the State. *Id.* §§ 3905.01, 3905.42, 3909.01.

Certain transactions that might threaten an insurer's solvency are specifically regulated under the statutory scheme. Mergers or acquisitions of domestic insurers, for example, require approval by the superintendent, who must withhold that approval if he finds that "[t]he financial condition of any acquiring party is such as might jeopardize the financial stability of the domestic insurer, or prejudice the interests of policyholders." *Id.* § 3901.321(F)(1)(c). Transactions

As one commentator has explained, the emphasis of the regulatory scheme is

> placed simply upon protecting the little policyholder who cannot tell when he is charged too much for his insurance; since he does not investigate his purchase too carefully nor could he determine if a given insurer has the capacity, *i.e.*, the solvency, *to perform in the future when the insured event occurs*, the States have established regulatory bodies to secure that necessary measure of protection.

Richards, *Insurance* § 39 (emphasis added) (quoted in *Fabe*, 939 F.2d at 350).[8] The structure and scope

between insurers and their affiliates are also subject to the superintendent's approval, which he cannot give if the amount of the transaction exceeds a certain percentage of the insurer's assets or its "surplus as regards policyholders." *Id.* § 3901.341.

Permitted investments are set forth in the statutes in great detail, with the evident purpose of prohibiting overly speculative investments and restricting the amounts insurers may place at risk. *Id.* §§ 3907.14, 3925.05, 3925.09. Loans are similarly limited, and life insurers may not declare dividends without first setting aside "an amount equal to the reserve on all . . . outstanding risks and policies." *Id.* §§ 3907.14, 3907.18, 3925.05.

[8] The first state statute to prioritize claims in insurer liquidations, that enacted by Wisconsin in 1967, Wis. Stat. Ann. § 654.68 (West 1991), served as the paradigm for NAIC's Model Act, which in turn provides the model for Ohio's statute and those of many other States. *See* Spencer L. Kimball, *History and Development of the Law of State Insurer Insolvency Proceedings: An Overview*, *in* Law and Practice of Insurance Company Insolvency 9, 21 & n.37 (David M. Spector ed., 1986). In the committee notes included in the Wisconsin legislation and printed in the session laws, *see id.* at 25, the Wisconsin legislature explained why federal (as well

of Ohio's regulatory scheme demonstrates its primary purpose—to protect the expectation of policyholders that their claims will be paid.

For this reason, state regulation of the "business of insurance" does not abruptly end when the insurer becomes insolvent. As the Ohio scheme demonstrates, when an insurer is threatened with insolvency or actually becomes insolvent, the State's interest in protecting the expectations of policyholders is no less great. In these circumstances Ohio's statute provides

as state and local) government claims had been given a lower priority than the claims of policyholders:

> When an insurer must be liquidated, the outcome is often tragic. While many of the losers will merely be inconvenienced, others may suffer losses or delays in receiving payment that will subject them at least to hardship and may even deprive them of the necessities of life. It becomes apparent that claims that are socially more important need to be paid ahead of those that are less important. Recognition of such social equities is commonplace in the law relating to insolvency and bankruptcy.
>
> In an effort to minimize the harm done by liquidation, and especially to lessen it for those persons least able to bear it, much thought and consultation went into the structuring of the priority system. . . . There is no justification for giving a high priority to the sovereign because it is sovereign. On the merits, indeed, there seems an unanswerable case for declining to prefer government claims, including claims of taxes, and for giving priority to claims of greater social importance, such [as] the unearned premium reserve and, a fortiori, loss claims. The sovereign, and in particular the United States, will be able to survive without hardship even if relegated to the priority accorded ordinary creditors.

Wis. Stat. Ann. § 645.68 committee comment (West 1980) at 508, 512. *See also* Kimball, *supra*, at 33.

for active supervision by the State via three different levels of oversight.

First, the superintendent, upon finding "that [the] insurer is in such condition as to render the continuance of its business hazardous to the public or to holders of its policies or certificates of insurance," Ohio Rev. Code § 3903.09(B), may place the company under "supervision." *Id.* § 3903.09(C). Second, the superintendent may seek court approval to "rehabilitate" the insurer when, *inter alia*, "[t]he insurer is in such condition that the further transaction of business would be hazardous, financially, to its policyholders, creditors, or the public." *Id.* § 3903.12(A). An order of rehabilitation places the assets and management of the company in the hands of the superintendent, who is charged with doing whatever he "considers necessary or appropriate to reform and revitalize the insurer." *Id.* §§ 3903.13, 3903.14(B).

The greatest degree of state oversight occurs in the event of liquidation, which typically occurs only after an unsuccessful rehabilitation effort. *See* Howard, *Uncle Sam Versus the Insurance Commissioners: A Multi-Level Approach to Defining the "Business of Insurance" under the McCarran-Ferguson Act*, 25 Willamette L. Rev. 1, 9 (1989). In liquidation, the objective of the superintendent shifts from revitalizing the insurer to paying claims. Indeed, receiving and making determinations on claims is the superintendent's principal concern once a company enters liquidation. *See* Ohio Rev. Code §§ 3903.26-30, 3903.35-44.[9]

[9] The potential for federal disruption of orderly state administration of insolvencies based upon abusive assertions of first priority is virtually limitless. For example, in one recent

B. The United States, however, grossly mischaracterizes liquidation as a clean-up operation that occurs only after an insurer is no longer conducting the "business of insurance." According to the United States, Ohio's priority statute is not directed to the insurer but to the liquidator of its estate and "comes into play only when . . . [t]he only business being conducted is the liquidation of a corporation which happens to have been an insurance company." Pet. Br. 14 (quoting *Idaho ex rel. Soward v. U.S.*, 858 F.2d 445, 452 (9th Cir. 1988), *cert. denied*, 490 U.S. 1065 (1989)). This argument is untenable.

To be sure, once a company enters liquidation it is no longer an ongoing concern with the primary aim of generating profits. Yet in its ordinary meaning, the term "business" does not necessarily embrace profit-generating activity. Webster's New Collegiate Dictionary, for example, defines the term, *inter alia*, as "Role, Function," "an immediate task or objective." Certainly, the "function" and "immediate objective" of insurance is the payment of policyholders' claims. *See, e.g., Pireno*, 458 U.S. at 136 ("The key representation of the insurance company and the principal expectation of the policyholder is that prompt payment will be made when the event insured

case, the Resolution Trust Corporation filed claims totalling $7.5 *billion* alleging that the now insolvent insurer had been "a link in [a] junk bond 'daisy chain' that artificially inflated the price of junk bonds and indirectly led to the failure of about 50 thrifts." Kristof, *Settlement is Proposed on Failed Insurer*, L.A. Times, June 23, 1992, at D2. The liquidator settled the claims for approximately $5 million (less than one-one thousandth of the amount RTC sought) solely to avoid "years of litigation that could indefinitely stall rehabilitation of the failed insurer." *Id.*

against actually occurs.") (Rehnquist, J., dissenting); *Royal Drug*, 440 U.S. at 213 ("fundamental element[] of insurance is . . . the payment of a premium in exchange for a promise to indemnify the insured against losses upon the happening of a specified contingency"); *see also* authorities cited *supra* at 9-10. From the policyholder's perspective it is irrelevant whether his claim is paid by a functioning insurer engaged in profit-making activity or one in liquidation. *See Pireno*, 458 U.S. at 132 ("to the policyholder, . . . [the] only concern is *whether* his claim is paid, not *why* it is paid"). And in any case, it is "the 'business of insurance' and not the 'business of insurance companies' " which McCarran-Ferguson speaks to. *Id.* at 132 (quoting *Royal Drug*, 440 U.S. at 217).

Ohio's statute, like other state statutes that regulate the priority of claims, is thus an essential part of state efforts to protect policyholders through regulation. When an insurer enters liquidation, conferring a favored priority on the claims of policyholders is Ohio's last resort in its effort to make sure that insurance companies live up to their obligations.[10]

---

[10] Many jurisdictions that grant policyholders priority have decided that claims by insurance companies against insolvent reinsurers do not qualify as claims of policyholders, reaffirming the principle that the purpose of the priority and other insolvency regulatory provisions is to protect the policyholding public. As the Virginia Supreme Court put it,

> The average individual property owner is uninformed as to many of the details of the business [of insurance], and, for this and other reasons, is not in a position to judge of the solvency of any particular company. The danger of imposition upon its citizens by irresponsible companies is one of the controlling reasons for the enactment of such a provision.

Shepard v. Virginia State Ins. Co., 120 Va. 383, 91 S.E. 140, 141 (1917). *See also Cunningham v. Republic Ins. Co.*, 94 S.W.2d 140, 142-43 (Tex. Civ. App. 1936) (quoting *Shepard*); *Aetna Casualty & Surety Co. v. Int'l Reinsurance Corp.*, 117 N.J. Eq. 190, 175 A. 114, 121 (1934); *Foremost Life Ins. Co. v. Dep't of Ins.*, 274 Ind. 181, 409 N.E.2d 1092, 1097 (1980); *In re Liquidations of Reserve Ins. Co.*, 122 Ill. 2d 555, 524 N.E.2d 538 (1988); *Van Schaick v. General Indemnity Corp.*, 274 N.Y. 510, 10 N.E.2d 523 (1937); *State v. Beacon Ins. Co.*, 87 N.C. App. 72, 359 S.E.2d 508, 511 (1987) (purpose of policyholder priority is to protect "consumer, who must rely upon the industry for protection, and yet who clearly does not have equal knowledge or resources at his disposal in his dealings with the business of insurance"); *Neff v. Cherokee Ins. Co.*, 704 S.W.2d 1 (Tenn. 1986).

B. McCarran-Ferguson Recognizes the Traditional Authority of the States to Regulate Insurer Insolvencies.

The United States argues that McCarran-Ferguson has a "narrow reach," extending only to state regulation of policy formation and interpretation. Pet. Br. 13, 18-19. To the contrary, at the time McCarran-Ferguson was enacted, the States had long exercised broad regulatory authority over the "business of insurance," including insurer insolvencies.

The regulation of insurance "has traditionally been under the control of the states." *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65, 69 (1959); *see also Paul v. Virginia*, 75 U.S. (8 Wall.) 168, 183 (1868), ("[i]ssuing a policy of insurance is not a transaction of commerce" within the Commerce Clause). For the seventy-five years after *Paul*, that case was understood to have "nullif[ied] federal authority" over the insurance business, making regulation of insurance a state matter. *Prudential Ins. Co. v. Benjamin*, 328 U.S. 408, 414 (1946). *Paul* re-

mained the law until it was overruled in *United States v. South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944).[11]

[11] Relying on *United States v. Knott*, 298 U.S. 544 (1936), the United States argues that McCarran-Ferguson could not have given States the right to prioritize policyholders' claims ahead of those of the United States because the States had no such right prior to *South-Eastern Underwriters*. Pet. Br. 24-25. In *Knott*, the United States demanded payment of judgments it recovered on appearance bonds, asserting that it was entitled to priority. While this Court concluded that the United States' claim was "entitled to priority" over the claims of in-state creditors, 298 U.S. at 548, there is no indication that the in-state creditors were policyholders of the type given priority by the Ohio statute or that the Florida insolvency statute gave priority to policyholders in a manner similar to the Ohio statute. At most, *Knott* stands for the entirely unremarkable proposition that, in paying the claims of a class of creditors, a State cannot give priority to other creditors over the United States solely on the basis of its governmental status. Moreover, no issue of whether a statute could give priority to the claims of policyholders over any claim of the United States was present.

The United States also relies on cases from New York, New Jersey and Louisiana to argue that the States had, prior to *South-Eastern Underwriters*, acknowledged the preemptive force of the federal superpriority statute in insurer insolvency proceedings. *See* Pet. Br. 24 n.11. Neither the New Jersey case, *Fred L. Emmons, Inc. v. Union Indemnity Co.*, 175 A. 141 (N.J. 1934), nor the New York cases, *In re Casualty Co. of America*, 196 A.D. 175, 176-77 (1st Dep't), *aff'd*, 232 N.Y. 559, 561 (1921), and *People v. Metropolitan Surety Co.*, 161 N.Y.S. 616 (1916), contain any indication that claims of policyholders were involved. Quite remarkably, the United States also relies on *Conway v. Imperial Life Ins. Co.*, 21 So.2d 151 (La. 1945). In *Conway*, the issue of the preemptive effect of the federal superpriority statute on policyholders' claims was squarely presented. The Louisiana Supreme Court held, however, that a state law requiring the insurer to deposit securities with the State Treasurer "for the benefit and protection of and as security for the policyholders" created a trust and that "the claim of the policyholders to the funds in question must prevail over the claim of the United States." 21 So.2d at 153.

Rightly or wrongly, Congress considered the *South-Eastern* decision " 'precedent-smashing.' " *Prudential*, 328 U.S. at 414 (quoting S. Rep. No. 1112, 78th Cong., 2d Sess. at 2). Faced with the possibility that *South-Eastern* had invalidated the entire existing system of state regulation, Congress enacted the McCarran-Ferguson Act for one purpose: " 'to broadly . . . give support to the existing and future state systems for regulating and taxing the business of insurance.' " *SEC v. National Securities, Inc.*, 393 U.S. 453, 458 (1969) (quoting *Prudential*, 328 U.S. at 429). Congress manifested its intent "to throw the whole weight of its power behind the state systems," *Prudential*, 328 U.S. at 430, as evidenced by McCarran-Ferguson's "Declaration of Policy" that "the continued regulation and taxation by the several States of the business of insurance is in the public interest." 15 U.S.C. § 1011.

To be sure, McCarran-Ferguson did not exempt every activity of insurance companies from federal regulation. This Court, however, has made clear that Congress intended that the core of insurance regulation—regulation of the insurer-policyholder relationship—remain securely within the States' ambit:

> Congress was concerned with the type of state regulation that centers around the contract of insurance, the transaction which *Paul v. Virginia* held was not 'commerce.' The relationship between insurer and insured, the type of policy which could be issued, its *reliability*, interpreta-

> tion, and *enforcement*—these were the core of the 'business of insurance.' Undoubtedly, other activities of insurance companies relate so closely to their status as reliable insurers that they too must be placed in the same class. But whatever the exact scope of the statutory term, it is clear where the focus was—it was on *the relationship between the insurance company and the policyholder.*

SEC v. National Securities, Inc., 393 U.S. at 460 (emphasis added). Accordingly, state laws "aimed at protecting or regulating this relationship, *directly or indirectly*, are laws regulating the 'business of insurance.'" *Id.* (emphasis added).

State laws regulating insurer solvency plainly go to "the core of the 'business of insurance'" as it was understood at the time McCarran-Ferguson was enacted. *See, e.g., Robertson v. California*, 328 U.S. 440, 459-62 (1946) (upholding state authority to enforce minimum asset requirements for insurers). As *Robertson* noted,

> [*South-Eastern*] did not wipe out the experience of the states in the regulation of the business of insurance or its effects for the continued validity of that regulation. Much of this was concerned with the activities of so-called foreign insurance companies and, in particular, *with requirements designed to secure minimum guaranties of solvency and ability to pay claims as they mature.*

Robertson, 328 U.S. at 457-58 (emphasis added).[12] If anything is critical to the "reliability" of insur-

[12] Although the case was not decided under McCarran-Ferguson because the criminal conviction under review took place before passage of the Act, the Court noted that "the

ance policies and the issuing companies' "status as reliable insurers," *National Securities*, 393 U.S. at 460, it is the companies' solvency. State regulation directed at ensuring solvency is quintessential regulation of "the relationship between the insurance company and the policyholder," *id.*, because it is designed to uphold the policyholder's expectations.

Just as the prevention of insurer insolvency was within the States' domain when McCarran-Ferguson was enacted, so too was the regulation of insurer insolvency. *See, e.g., United States v. Knott*, 298 U.S. 544 (1936); *In re Union Guar. & Mortgage Co.*, 75 F.2d 984 (2d Cir. 1935) (L. Hand, Swan, and A. Hand, JJ.); *In re Peoria Life Ins. Co.*, 75 F.2d 777 (7th Cir.), *cert. denied*, 296 U.S. 594 (1935). Congress so legislated in 1910, when it amended the Bankruptcy Act of 1898[13] to specify that insurance companies could not liquidate under federal law. *See* Act of June 25, 1910, ch. 412, 36 Stat. 839.[14] Congress' purpose was

> to leave to local winding up statutes the liquidation of such companies; that, since the states commonly kept supervision over them during their lives, it was reasonable that they should take charge on their demise.

Union Guar. & Mortgage Co., 75 F.2d at 984. Congress thus expressly recognized the tradition of state regulation of insurer insolvency.

McCarran Act, if applied, would dictate the same result." *Robertson*, 328 U.S. at 462.

[13] Act of July 1, 1898, ch. 541, 30 Stat. 544.

[14] Congress reenacted the insurance company exclusion in 1938. *See* Chandler Act, Act of June 22, 1938, ch. 575, 52 Stat. 845 (1938).

In "throw[ing] the whole weight of its power behind the state systems," the McCarran-Ferguson Congress "must have had full knowledge of the nation-wide existence of state systems of regulation and taxation." *Prudential*, 328 U.S. at 430. Protection of policyholders' interests in liquidations is just as much within the "core of the 'business of insurance,'" *National Securities*, 393 U.S. at 460, as insolvency prevention. *See, e.g., Conway v. Imperial Life Ins. Co.*, 21 So.2d 151, 153 (La. 1945). Under Ohio's priority statute, liquidation proceedings are principally concerned with the "reliability" and "enforcement" of the promises made by insurers to policyholders. *National Securities*, 393 U.S. at 460. Enforcement of those promises goes directly to "the relationship between the insurance company and the policyholder." *Id.* The McCarran-Ferguson Congress clearly viewed those enforcement mechanisms as regulation of the "business of insurance."

C. Under *National Securities*, Ohio's Statute Regulates the "Business of Insurance"; the *Pireno* Criteria are Inapplicable Here Because They were Devised to Construe McCarran-Ferguson's Narrow Antitrust Exemption.

This Court has only once considered whether a particular state statute was "enacted . . . for the purpose of regulating the business of insurance" under McCarran-Ferguson. *See National Securities*, 393 U.S. at 453. *National Securities* involved whether two distinct provisions of Arizona law were preempted by the federal securities laws or were permissible state regulations of the business of insurance. The first provision required that the Arizona Director of Insurance approve a merger involving a state insurer only if it was fair to the company's

stockholders and not otherwise contrary to law. The Court held that the law did not regulate the "business of insurance," noting that "[t]he crucial point is that here the State has focused its attention on stockholder protection; it is not attempting to secure the interests of those purchasing policies." *Id.* at 460.

The second provision required the Director to find that the transaction "would not 'substantially reduce the security of and service to be rendered to policyholders' before he gives his approval." *Id.* at 462 (quoting Ariz. Rev. Stat. Ann. § 20-731(B)(3) (Supp. 1969)). This Court readily concluded that the statute "clearly relate[d] to the 'business of insurance.'" *Id.* This Court thus held that state regulation of the "security" of insurance—that is, insurer solvency regulation—constitutes regulation of the "business of insurance."

Ohio's priority statute is, of course, an "attempt[] to secure the interests of those purchasing policies." *Id.* at 460. Moreover, the provision is clearly aimed at protecting "the security of and service to be rendered to policyholders." *Id.* at 462. *National Securities*' analysis thus fully supports the conclusion that the Ohio statute regulates the "business of insurance."

Ignoring the manifest purpose of subsection 2(a) of McCarran-Ferguson to preserve the States' broad regulatory authority, the United States principally relies on *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982), and *Group Life & Health Ins. v. Royal Drug*, 440 U.S. 205 (1979), to argue that Ohio's priority statute does not regulate the "business of insurance." The United States' reliance on these two cases, which interpret McCarran-Ferguson's an-

titrust exemption of subsection 2(b), 15 U.S.C. § 1012 (b), is misplaced.

It is obvious that both Congress' grant to the States of the authority to regulate insurers and the antitrust exemption use the same "business of insurance" language.[15] These two provisions of McCarran-Ferguson serve entirely distinct purposes, however, as this Court recognized in *Royal Drug*:

> There is no question that the *primary* purpose of the McCarran-Ferguson Act was to preserve state regulation of the activities of insurance companies, as it existed before the *South-Eastern Underwriters* case. . . . The McCarran-Ferguson Act operates to assure that the States are free to regulate insurance companies without fear of Commerce Clause attack. . . . [T]he quite different *secondary* purpose of the McCarran-Ferguson Act [is] to give insurance companies only a limited exemption from the antitrust laws.

440 U.S. at 218 n. 18 (emphasis in original). Given the distinct purpose of each provision, it does not follow that this Court's identification in both *Pireno* and *Royal Drug* of three criteria for "determining whether *a particular practice* is part of the 'business of insurance' *exempted from the antitrust laws by 2(b)*,"

[15] The full text of the antitrust exemption reads:

> . . . *Provided*, That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State Law.

15 U.S.C. § 1012(b).

Pireno, 458 U.S. at 129 (emphasis added), controls the very different question of whether a State has regulated the "business of insurance." As *Pireno* itself states, its three criteria are relevant in determining the scope of the antitrust exemption, an exemption which is to be narrowly construed. *Id.* at 126; *see also FMC v. Seatrain*, 411 U.S. 726, 733 (1973). *Pireno* does not even purport to establish a test applicable for determining whether a state law regulates the "business of insurance." *See generally* 458 U.S. at 126-30.

Indeed, *Pireno's* three criteria—"*first*, whether the practice has the effect of transferring or spreading a policyholder's risk; *second*, whether the practice is an integral part of the policy relationship between the insurer and the insured; and *third*, whether the practice is limited to entities within the insurance industry[,]" 458 U.S. at 129 (emphasis in original),—are simply inapplicable beyond the specific "practices" challenged in the antitrust context.[16] The focus of both *Pireno* and *Royal Drug* is on whether an insurer's particular business practice constitutes the "business of insurance" consistent with the narrow purpose of the antitrust exemption to allow for "cooperative

[16] To be sure, this Court has used the *Pireno* criteria to construe ERISA's clause saving from preemption any state law "which regulates insurance." *See, e.g., Metropolitan Life Ins. Co. v. Mass.*, 471 U.S. 724, 740 (1985) (state minimum benefit law "regulate[d] insurance" and was not preempted by ERISA § 514(b)(2)). The Court's reliance on the *Pireno* criteria was but one of several independent grounds offered in support of the result. Of note, this Court has never applied the *Pireno* criteria outside of the antitrust context to hold, as the United States asks the Court to do here, that a state law did not regulate the "business of insurance."

ratemaking" on the part of insurers. *Royal Drug*, 440 U.S. at 221.[17]

Of equal significance here, *Royal Drug* makes clear that at "the core of the business of insurance" is the insurer's payment of the policyholder's claims. As this Court noted in rejecting the insurer's argument that the pharmacy reimbursement agreement constituted the "business of insurance":

> The fallacy of the petitioners' position is that they confuse the obligations of [the insurer] under its insurance policies, which insure against the risk that policyholders will be unable to pay for prescription drugs during the period of coverage, and the agreements between [the insurer] and the participating pharmacies, which serve only to minimize the costs [the insurer] incurs in fulfilling its underwriting obligations. The benefit promised to [the] policyholders is that their premiums will cover the cost of prescription drugs except for a $2 charge for each prescription. *So long as that promise is kept*, policyholders are basically unconcerned with arrangements made between [the insurers] and participating pharmacies.

Royal Drug, 440 U.S. at 214 (footnotes omitted; emphasis added); *see also Pireno*, 458 U.S. at 132 (the

[17] Of note, neither *Pireno* nor *Royal Drug* involved "the core of the 'business of insurance,'" *Pireno*, 458 U.S. at 128 (quoting *National Securities*, 393 U.S. at 460), that is, "the 'relationship between insurer and insured, the type of policy which could be issued, its *reliability*, interpretation, and *enforcement*." *Id.* (emphasis added). Neither the reimbursement agreement between the insurer and pharmacies at issue in *Royal Drug*, *see* 440 U.S. at 209, nor the peer review procedre at issue in *Pireno*, *see* 458 U.S. at 122-23, directly involve the promise of an insurer to pay claims.

"only concern [of the policyholder] is *whether* his claim is paid, not *why* it is paid") (emphasis in orignal). Both *Royal Drug* and *Pireno* make clear that the payment of the policyholder's claims is at the "core of the 'business of insurance.'" *Pireno*, 458 U.S. at 128; *Royal Drug*, 440 U.S. at 215-216 (both quoting *National Securities*, 393 U.S. at 460). Because the *Pireno* criteria are concerned solely with the *insurer's* understanding of the "business of insurance," and disregard the perspective of the *policyholder*, it is particularly inappropriate to apply them here.

In short, both *Pireno* and *Royal Drug* make clear that their three criteria are inapplicable outside of the antitrust context. The United States' insistence that these criteria apply in this case ignores the fundamental purpose of insurance, the broad authority Congress gave the States to regulate the "business of insurance" and the limited scope of McCarran-Ferguson's antitrust exemption.[18]

[18] The United States also relies on dictum in *Royal Drug* which states that statutes regulating "such diverse aspects of . . . plans as . . . when they could liquidate or merge" do not regulate the business of insurance. *See Royal Drug*, 440 U.S. at 230 n.38; *see also* Pet. Brief at 15. The United States' argument is contradicted by this Court's holding in *National Securities* that a state law requiring the Director of Insurance to find that a merger "would not 'substantially reduce the security of and service to be rendered to policyholders' before . . . giv[ing] his approval," was a valid state regulation of the "business of insurance." 393 U.S. at 462. The United States' position is further undercut by *Royal Drug's* own acknowledgment that it is the insurer's promise of payment to the policyholder that is at the "core of the 'business of insurance.'" *See* 440 U.S. at 211-17.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted,

RICHARD RUDA *
Chief Counsel
JAMES I. CROWLEY
STATE AND LOCAL LEGAL CENTER
444 N. Capitol Street, N.W.
Suite 345
Washington, D.C. 20001
(202) 434-4850

* *Counsel of Record for the* Amici Curiae

MICHAEL J. WAHOSKE
DANIEL P. O'KEEFE
JOHN B. ORENSTEIN
CATHERINE A. GNATEK
DORSEY & WHITNEY
2200 First Bank Place East
Minneapolis, Minnesota 55402
(612) 340-2600
Of Counsel

Sepember 8, 1992

(12)

No. 91-1513

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

UNITED STATES DEPARTMENT OF THE TREASURY and MITCHELL A. LEVINE, ASSISTANT COMMISSIONER,
Petitioners

v.

GEORGE FABE, SUPERINTENDENT OF INSURANCE, STATE OF OHIO,
Respondent

On Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

BRIEF OF THE NATIONAL CONFERENCE OF INSURANCE GUARANTY FUNDS AND THE NATIONAL ORGANIZATION OF LIFE & HEALTH INSURANCE GUARANTY ASSOCIATIONS AS AMICI CURIAE IN SUPPORT OF RESPONDENT

F. JAMES FOLEY
Counsel of Record
VORYS, SATER, SEYMOUR AND PEASE
52 East Gay Street
P.O. Box 1008
Columbus, Ohio 43216-1008
(614) 464-5411
Attorney for Amici Curiae National Conference of Insurance Guaranty Funds and National Organization of Life & Health Insurance Guaranty Associations

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

TABLE OF CONTENTS

TABLE OF AUTHORITIES

TABLE OF AUTHORITIES—Continued

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

No. 91-1513

UNITED STATES DEPARTMENT OF THE TREASURY and MITCHELL A. LEVINE, ASSISTANT COMMISSIONER,

Petitioners

v.

GEORGE FABE, SUPERINTENDENT OF INSURANCE, STATE OF OHIO,

Respondent

On Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

---

BRIEF OF THE NATIONAL CONFERENCE OF INSURANCE GUARANTY FUNDS AND THE NATIONAL ORGANIZATION OF LIFE & HEALTH INSURANCE GUARANTY ASSOCIATIONS AS AMICI CURIAE IN SUPPORT OF RESPONDENT

INTEREST OF THE AMICI CURIAE

The National Conference of Insurance Guaranty Funds ("NCIGF") is an organization of the property and casualty insurance guaranty associations of the various states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. These insurance guaranty associa-

tions are generally not-for-profit unincorporated associations created by special state statute. The statutes creating the insurance guaranty associations were almost universally based on the Post-Assessment Property and Liability Insurance Guaranty Association Model Act ("P&L Model Act") which was first promulgated by the National Association of Insurance Commissioners ("NAIC") in 1969.

The P&L Model Act, and the state statutes which it inspired, are intended:

> to provide a mechanism for the payment of covered claims under certain insurance policies, to avoid excessive delay in payment and to avoid financial loss to claimants or policyholders because of the insolvency of an insurer, to assist in the detection and prevention of insurer insolvencies, and to provide an association to assess the cost of such protection among insurers.

Consistent with that purpose, the insurance guaranty associations provide some limited protection to certain insureds in the event their insurance company becomes insolvent. The specific duties of these associations are defined and limited by the statutes creating them.[1] However, generally speaking, the guaranty associations pay "covered claims" which arise out of insurance policies issued by insurers which have become "insolvent insurers" as those terms are defined and limited by statute.[2]

The National Organization of Life & Health Insurance Guaranty Associations ("NOLHGA") is a not-for-profit association whose members are the life and health insur-

[1] For example, the Ohio Insurance Guaranty Association was established pursuant to Ohio Rev. Code Ann. § 3955.06 (Anderson Supp. 1991) and is governed by the Ohio Insurance Guaranty Association Act, Ohio Rev. Code Ann. § 3955.01 *et seq.* (Anderson Supp. 1991).

[2] P&L Model Act at Section 5(6); Ohio Rev. Code Ann. § 3955.01 (B) and § 3955.01(C) (Anderson Supp. 1991).

ance guaranty associations of the fifty states and Puerto Rico. Life and health insurance guaranty associations are generally not-for-profit, unincorporated associations chartered pursuant to state law to help protect life insurance policyholders, health insurance policyholders, annuity contract holders and certain other persons (hereinafter "insureds") against the failure of their insurance company. The scope of protection provided by these associations is limited and there is variation between the states as to the types of insurance obligations covered and the dollar amounts of those coverages.

Most life and health insurance guaranty associations were chartered under individual state enactments of the NAIC Life and Health Insurance Guaranty Association Model Act of 1987 (the "Life and Health Model Act") or one of its antecedents.[3] The official commentary to that Act states that its basic purpose is to "[T]o protect policyowners, insureds, beneficiaries, annuitants, payees and assignees against losses (both in terms of paying claims and continuing coverage) which might otherwise occur due to an impairment or insolvency of an insurer."

Like their property and casualty counterparts, life and health insurance guaranty associations require all companies chartered by or admitted into a state, which write the lines of business covered by the guaranty association, to become members subject to guaranty association assessments. Unlike their property and casualty counterparts however, whose principal constraint is to pay covered claims, life and health insurance guaranty associations generally seek to continue the long-term life, health and annuity obligations of a failed insurer by reinsuring those obligations with a financially sound reinsurer.

[3] The Ohio Life and Health Insurance Guaranty Association was enacted pursuant to Ohio Rev. Code Ann. § 3956.06 (Anderson Supp. 1991) and is governed by the Ohio Life and Health Insurance Guaranty Association Act, Ohio Rev. Code Ann. § 3956.01 *et seq.* (Anderson Supp. 1991).

But it is well to keep in mind that life and health insurance companies write any number of insurance products the contractual obligations of which (i) exceed guaranty association limits of protection or (ii) are not accorded any protection whatsoever. The estate of the failed insurer is the only refuge for persons with claims that exceed or are not covered by guaranty association protections.

The state insurance guaranty associations represented by NCIGF and NOLHGA are part of the comprehensive system enacted by the states to handle insurance company insolvencies. All guaranty associations work closely with state officials, typically the insurance commissioner, legally responsible for the rehabilitation, conservation or liquidation of a financially impaired or insolvent insurance company. The creation of guaranty associations by the states is but one example of how insurance company insolvencies have been handled under the aegis of state law, rather than federal law. The guaranty associations act as a limited safety net in covering certain obligations of insolvent insurers to their insureds and third-party claimants. Claims not covered by a guaranty association are generally submitted directly to the insurance company in liquidation to be handled by the liquidator. In those cases where claims are paid by a guaranty association, under state insurance insolvency laws the subrogation claims of guaranty associations have the same priority as claims of insureds.[4]

As a result of the above-described state based system of resolving insurance insolvencies, the insurance company liquidator and the appropriate insurance guaranty associations are the two primary sources of protection of insureds of insolvent insurance companies. Accordingly, the various state guaranty associations have a strong involvement and interest in the present system whereby the states determine the priority of claims

[4] See, e.g., Ohio Rev. Code Ann. § 3903.42(C) (Anderson 1989).

against insolvent insurance companies as part of the general, comprehensive state-based system of regulating the business of insurance.[5]

SUMMARY OF ARGUMENT

The United States Department of the Treasury (the "Treasury Department") has filed claims of approximately $10.7 million on various bonds issued by the now insolvent American Druggists Insurance Company ("ADIC"). The Treasury Department has asserted that its claims are entitled to first priority under 31 U.S.C. 3713(a)(1)(A)[6]. The Liquidator of ADIC, George Fabe, the Superintendent of Insurance of the State of Ohio, has maintained that the federal claims are entitled to fifth priority under the Ohio Insurers Supervision, Rehabilitation, and Liquidation Act, Ohio Rev. Code Ann. § 3903.01 *et seq.* (Anderson 1989 & Supp. 1991) ("Insurers Liquidation Act"). Under the Ohio statute, claims are paid in the following order: (1) administrative expenses, (2) wage and benefit claims, (3) policyholder claims, (4) claims of general creditors, and (5) claims of federal, state and local governments. Additionally, there are three lower classes of claims. Ohio Rev. Code Ann. § 3903.42 (Anderson 1989).

Given this conflict between the federal and state laws, the Treasury Department has argued that the Ohio law is preempted by 31 U.S.C. 3713(a)(1)(A). The Liqui-

[5] Pursuant to Sup. Ct. R. 37.3, the parties' written consents to the filing of this amici curiae brief have been filed with the Clerk.

[6] 31 U.S.C. 3713(a)(1)(A) provides that:

> A claim of the United States Government shall be paid first when—
>
> (A) a person indebted to the Government is insolvent and—
>
> (i) the debtor without enough property to pay all debts makes a voluntary assignment of property;
>
> (ii) property of the debtor, if absent, is attached; or
>
> (iii) an act of bankruptcy is committed. . . .

dator has countered that preemption of the Ohio law is barred by virtue of the McCarran-Ferguson Act, 15 U.S.C. § 1011 *et seq.* That Act provides, inter alia, that "No Act of Congress shall be construed to invalidate, impair or supersede any law enacted by any State for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance." 15 U.S.C. 1012(b).

Clearly, the federal general priority statute, 31 U.S.C. 3713, is not an Act that "specifically relates to the business of insurance." Hence the core issue in this appeal is whether the Ohio law regulating insurance company insolvencies, and, specifically, prioritizing claims against insolvent insurance companies, regulates "the business of insurance." Based on both the plain meaning of the statute and this Court's prior analysis of the scope of McCarran-Ferguson, NCIGF and NOLHGA believe the Ohio insurance insolvency statute clearly regulates the business of insurance.

1. The starting point in any issue of statutory construction is the plain language of the statute itself. If the meaning of the statute is clear on its face, there is no need to proceed any further. In the present case, the issue is whether the Ohio insurance code provision establishing the relative priorities of claims against insolvent insurance companies regulates "the business of insurance." The very essence of the business of insurance is the payment of insureds when potential risks become actual claims. Since the Ohio insurance insolvency statute determines, as a practical matter, if and how much an insured (or claimant) will get paid, the Ohio law clearly regulates the business of insurance.

2. If the Court moves beyond the plain language of the statute to cases interpreting it, it will not find any of its own decisions directly on point. However, this Court has recently decided three cases interpreting the phrase "the business of insurance" which support the

conclusion that the Ohio statute is the type of regulation covered by McCarran-Ferguson. *SEC v. National Securities, Inc.*, 393 U.S. 453 (1969); *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205 (1979); *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982). The first of those cases held that the McCarran-Ferguson Act was concerned with matters such as the "relationship between insurer and insured," the "reliability" and "enforcement" of insurance policies, and the companies' "status as reliable insurers." 393 U.S. at 460. The Ohio priority statute gives a high priority to the claims of insureds against an insolvent insurance company. This increases the reliability of their policies and their ability to enforce them. This in turn enhances the relationship between the insurer and insured as set forth by *National Securities* so as to bring the Ohio priority statute under the protection of McCarran-Ferguson.

Royal Drug and *Pireno* analyzed three factors to determine if a practice by a state regulates the business of insurance:

a) "whether the practice has the effect of transferring or spreading a policyholder's risk"

b) "whether the practice is an integral part of the policy relationship between the insurer and the insured"

c) "whether the practice is limited to entities within the insurance industry"

458 U.S. at 129. The Ohio statute, which gives a high priority to insureds' claims, meets each of these three criteria. First, the priority assigned to a policyholder's claim will have a direct bearing and a major impact on whether the policyholder has in fact transferred the risk in the event his or her insurance company goes insolvent. Second, the most integral part of the policy relationship—from the point of view of the insured—is whether the insurer pays the claims it admittedly owes. The Ohio

priority scheme, which maximizes the likelihood of such payment in the event of insolvency, thus deals with a fundamental part of the relationship between the insurer and insured. Third, the Ohio Insurers Liquidation Act deals solely with the priority of claims against insurance companies. It does not attempt to regulate claims against any entities outside the insurance industry.

In sum, the Ohio Act comes within the clear meaning of the McCarran-Ferguson Act and within the meaning as analyzed by the prior decisions of this Court.

ARGUMENT

I. A STATE STATUTE WHICH PRIORITIZES CLAIMS AGAINST INSOLVENT INSURANCE COMPANIES REGULATES "THE BUSINESS OF INSURANCE" UNDER THE PLAIN MEANING OF THAT PHRASE AS USED IN THE McCARRAN-FERGUSON ACT.

The field of insurance has long been an area of dominant state concern. This Court held early on that "[i]ssuing a policy of insurance is not a transaction of commerce" *Paul v. Virginia*, 75 U.S. (8 Wall) 168, 183 (1868). It was therefore widely believed and held that insurance was not subject to federal regulation under the Commerce Clause. Thus, the Court surprised and raised great concerns within the insurance industry and the state and federal governments when it ruled in *United States v. South-Eastern Underwriters Ass'n.*, 322 U.S. 533 (1944), that insurance transactions are subject to federal regulation under the Commerce Clause in general, and the antitrust provisions of the Sherman Act in particular.

Congress reacted quickly to *South-Eastern Underwriters* by passing the McCarran-Ferguson Act, 15 U.S.C. 1011 *et seq.* That Act reflects the long-established national policy that insurance be regulated at the state level:

> Congress declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.

15 U.S.C. 1011. That general statement of policy was codified by the Congress in a specific provision which protects against preemption of state laws in this field by the federal government:

> No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance: *Provided*, That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law.[7]

15 U.S.C. 1012(b).

---

[7] It is noteworthy that unlike the Sherman Act, the Clayton Act and the Federal Trade Commission Act, the federal priority law, 31 U.S.C. 3713(a)(1)(A) was not deemed by McCarran-Ferguson to be applicable to the business of insurance, even though the federal priority statute had been enacted long before McCarran-Ferguson. Furthermore, while Congress has subsequently declared other federal laws to be applicable to the insurance industry notwithstanding McCarran-Ferguson, it has never made such a declaration about 31 U.S.C. 3713(a)(1)(A). "[T]he Sixth Circuit has established that '[v]arious statutes enacted by Congress . . . have been amended to establish federal dominance in certain areas pursuant to the McCarran-Ferguson Act. Nevertheless, 31 U.S.C. § 3173, the federal superpriority statute has not been amended to that effect.'" *Garcia v. Island Program Designer, Inc.*, No. 91-1679, 1992 WL 106774 (D. Puerto Rico, April 21, 1992) (copy included in the Appendix at 15a) (quoting the Sixth Circuit decision in the present case).

This case presents a clear conflict between state and federal law. On the one hand, Ohio and all the other states have enacted a comprehensive statutory scheme regulating insurance companies from the cradle to the grave. A significant section of that code deals with insolvent insurance companies in general and claims against them in particular. The Ohio statute prioritizes claims against these companies as follows:

(1) Administrative Expenses,

(2) Wage and Benefit Claims,

(3) Policyholder Claims,

(4) Claims of General Creditors,

(5) Claims of Federal, State and Local Governments,

(6) Late Filed Claims or Miscellaneous Claims,

(7) Surplus or Contribution Notes, and

(8) Claims of Shareholders or Other Owners.

Ohio Rev. Code Ann. § 3903.42 (Anderson 1989). Insurance codes in other states set similar priorities for claims. Federal law, by contrast, contains a general provision which grants the federal government a first priority for its claims against a debtor who has become insolvent. 31 U.S.C. 3713. This statute does not relate to insurance companies in particular.

Normally in a situation such as this, the Commerce and Supremacy Clauses of the U.S. Constitution would require that the state law be preempted by the federal law. However, as noted earlier, Congress has expressly barred the doctrine of preemption from applying to state laws regulating the business of insurance unless the federal law at issue "specifically relates to the business of insurance." In the present case, there is no question that 31 U.S.C. 3713 does not relate specifically to the business of insurance. Its terms speak generally to cases where someone indebted to the United States has become

insolvent; the federal law does not mention or refer to insurance companies in any way. Thus, the present dispute turns on the question of whether the Ohio statute prioritizing claims against insolvent insurance companies regulates the business of insurance.

In deciding whether the Ohio law regulates the business of insurance, the threshold consideration is the language of the McCarran-Ferguson Act itself. *Pennsylvania Public Welfare Dept. v. Davenport*, 495 U.S. 552, 557-558 (1990) ("Our construction . . . is guided by the fundamental canon that statutory interpretation begins with the language of the statute itself."); *Mallard v. U.S. Dist. Court for Southern Dist. of Iowa*, 490 U.S. 296, 300 (1989) ("Interpretation of a statute must begin with the statute's language."); *St. Paul Fire & Marine Ins. Co. v. Barry*, 438 U.S. 531, 541 (1978). If the meaning of that language is clear and plainly applies to the Ohio law, then there is no need for any additional analysis. *Freytag v. Commissioner of Internal Revenue*, 111 S. Ct. 2631, 2636 (1991) ("When we find the terms of a statute unambiguous, judicial inquiry should be complete except in rare and exceptional circumstances."); *Burlington Northern R. Co. v. Oklahoma Tax Comm'n*, 481 U.S. 454, 461 (1987). In this case, the Ohio provision at issue falls within the clear and plain meaning of the phrase "the business of insurance."

Ohio Rev. Code Ann. § 3903.42 is part of a comprehensive state statute regulating all aspects of the business of insurance. See Ohio Rev. Code Ann. Title 39 (Anderson 1989 & Supp. 1991). This comprehensive regulation of the insurance industry by the State of Ohio is typical of what is found in the other states as well. The regulation of insurance company insolvencies (Ohio Rev. Code Ann. Chapter 3903) is simply one part of this overall statutory scheme. It involves, *inter alia*, the appointment of a liquidator to marshall all the assets of the insurance company and the adjustment and payment of

claims against the insurance company. The insurance company is operated by the liquidator in most respects as an ongoing company, the primary exception being that it no longer takes on any new business during the liquidation proceedings. In other words, while the insolvency proceedings are pending, the insurance company continues to conduct most aspects of the business of insurance other than the solicitation of new customers and the issuance of new policies. For example, the liquidator may, and does, employ employees and agents;[8] conduct "the business . . . of the insurer;"[9] continue to prosecute and to commence in the name of the insurer any and all suits or legal proceedings;[10] enforce reinsurance contracts;[11] and collect unpaid earned premiums from any person.[12] The statutory scheme regulating insolvent insurance companies in Ohio is typical of the framework set up in the other states under the NAIC's Insurers Rehabilitation and Liquidation Model Act (1991).[13]

All of the regulations established by the Ohio statute, including the priority scheme, are designed to see that the *raison d'etre* of insurance—the payment of insureds' claims—in fact occurs:

> Up until the time there is a claim and a payment is made, the only tangible evidence of insurance is a piece of paper. In other words, the real product of insurance is the claims proceeds. Selection of the prospect, qualifying him for coverage that suits his

[8] Ohio Rev. Code Ann. § 3903.21(A)(2) and (3) (Anderson 1989).

[9] Ohio Rev. Code Ann. § 3903.21(A)(4) (Anderson 1989).

[10] Ohio Rev. Code Ann. § 3903.21(A)(12) (Anderson 1989).

[11] Ohio Rev. Code Ann. § 3903.32 (Anderson 1989).

[12] Ohio Rev. Code Ann. § 3903.33 (Anderson 1989).

[13] Section 42 of the Model Act deals with the priority of claims against insolvent insurance companies. See also Uniform Insurers Liquidation Act §§ 6-8, 13 U.L.A. 321-353 (1986).

> needs, delivery of a policy, collecting premiums for perhaps years, making changes in coverage to meet changing situations, all of these are but preambles to the one purpose for which the insurance was secured, namely to collect dollars if and when an unforeseen event takes place.

J. Wickman, *Evaluating the Health Insurance Risks*, 57 (1965). Thus, the state priority scheme falls within the plain and commonly understood meaning of the phrase "the business of insurance." It is the business of insurance to pay claims when a possible risk has blossomed into an actual claim. That act, more than any other act in the field of insurance, is what is commonly understood to be the business of insurance. Ohio Rev. Code Ann. § 3903.42 insures that the commonly understood meaning of the most basic business of insurance is a reality, even in those instances when an insurance company has become insolvent. As such, it is well within the meaning of the phrase "the business of insurance," if in fact not at the very core of that phrase. Accordingly, the McCarran-Ferguson Act dictates that the Ohio statute is not preempted and that Ohio law controls the disposition of all claims against American Druggist Insurance Company.

II. A STATE STATUTE WHICH PRIORITIZES CLAIMS AGAINST INSOLVENT INSURANCE COMPANIES REGULATES "THE BUSINESS OF INSURANCE" AS THAT PHRASE HAS BEEN INTERPRETED IN PRIOR SUPREME COURT CASES INVOLVING THE McCARRAN-FERGUSON ACT.

While this case presents an issue of first impression for this Court,[14] the Court has previously analyzed the

[14] Five federal court cases have addressed the specific issue now before the Court. The first two cases to decide this issue ruled that prioritizing claims against an insolvent insurance company did not constitute the business of insurance. *Gordon v. United States Dep't. of the Treasury*, 846 F.2d 272 (4th Cir.), *cert. denied*, 488 U.S. 954 (1988); *Idaho ex rel. Soward v. United States*, 858 F.2d 445 (9th

meaning of "the business of insurance" in other contexts. Although none of those cases were analogous to the present appeal the general language and analysis contained in three such cases supports respondent's position that McCarran-Ferguson includes within its scope the type of state statute at issue here.

In *SEC v. National Securities, Inc.*, 393 U.S. 453 (1969), the SEC attempted to enjoin violations of Section 10(b) of the Securities Exchange Act and Rule 10(b)-5 in connection with misrepresentations and omissions in communications by National Securities to shareholders of Producers Life Insurance Co. National Securities was proposing to merge Producers with an insurance company controlled by National Securities. After the SEC was denied temporary injunctive relief, the shareholders of Producers approved the merger. Pursuant to state law, the Arizona Director of Insurance found that the merger was not inequitable to Producer's shareholders and not otherwise contrary to law, and the merger was consummated. 393 U.S. at 457. The SEC thereafter amended its complaint seeking to unwind the merger. National Securities argued that since the merger had been approved by the State Director of Insurance pursuant to state law, McCarran-Ferguson barred the SEC's attempt to use the Securities Exchange Act to unwind the merger. The issue thus presented to the Court was whether the

---

Cir. 1988), *cert. denied*, 490 U.S. 1065 (1989). Subsequent to those two decisions, the Sixth Circuit created a conflict among the circuits by its decision in the present case. Since the Sixth Circuit decision herein, two United States District Courts have relied upon that decision in holding that the state commonwealth priority statutes for insolvent insurance companies regulated the business of insurance and therefore came within the protection of McCarran-Ferguson. *Garcia v. Island Program Designer, Inc.* No. 91-1679, 1992 WL 106774 (D. Puerto Rico, April 21, 1992) (hereinafter "*Garcia*"); *Lyons v. United States*, No. 4-91-10209 (S.D. Iowa, July 2, 1992) (hereinafter "*Lyons*") (copy included in the Appendix at 8a).

Arizona statute was a "law enacted . . . for the purpose of regulating the business of insurance." 393 U.S. at 457. This Court held that "[w]e do not believe that a state statute aimed at protecting the interests of those who own stock in insurance companies comes within the sweep of the McCarran-Ferguson Act." 393 U.S. at 457. The Court found that McCarran-Ferguson addressed concerns such as the "relationship between insurer and insured," the "reliability" and "enforcement" of insurance policies, and the companies' "status as reliable insurers." 393 U.S. at 460. By contrast:

> [A]rizona is concerning itself with a markedly different set of problems. It is attempting to regulate not the "insurance" relationship, but the relationship between a stockholder and the company in which he owns stock. This is not insurance regulation, but securities regulation. . . . The crucial point is that here the State has focused its attention on stockholder protection; it is not attempting to secure the interests of those purchasing insurance policies. Such regulation is not within the scope of the McCarran-Ferguson Act.

393 U.S. at 460.

Unlike the Arizona statute, Ohio Rev. Code Ann. § 3903.42 protects the insureds of insolvent insurance companies—not their shareholders. Insureds' claims are given a high priority—above those of general creditors, federal, state and local governments, late claims, miscellaneous claims, surplus or contribution notes and "claims of shareholders or other owners." Ohio Rev. Code Ann. § 3903.42 (Anderson 1989). As *Lyons* said of the comparable Iowa statute:

> The focus of the McCarran-Ferguson Act is on protecting policyholders. . . . [citing *National Securities*] The Sixth Circuit in *Fabe*, observed that "it is clear from the language and operation of [Ohio's Insolvent Insurer's statute] that its focus is the protection of

> insureds by diverting the scarce resources of the liquidated entity away from any non-insured creditors, toward policyholders." Iowa's insolvent insurer's statute is similarly focused.

Lyons at p. 13a. Thus, in protecting the policyholders of insolvent insurance companies, the Ohio statute has precisely the intent required by *National Securities*.

Additionally, unlike *National Securities*, the present case does not involve a party trying to invoke McCarran-Ferguson to evade liability for violations of federal law. The present suit is brought by the Liquidator of ADIC to maximize the assets available to insureds in the face of attempts by the federal government to jump ahead in line and thereby jeopardize whether the insureds will collect from their insurance company. If the Court accepts the position of the United States, the insureds will ultimately recover less than if the position of the Liquidator is upheld. Thus, consistent with the directive of *National Securities*, and unlike the state statute in that case, the Ohio law is designed to protect the interests of insureds.

The Court next visited the issue of the scope of "the business of insurance" in *Group Life & Health Insurance Co. v. Royal Drug Co.*, 440 U.S. 205 (1979). That case involved a Sherman Act claim against a Blue Shield insurance company in Texas. The suit claimed that contractual agreements Blue Shield had with pharmacies throughout the state of Texas violated § 1 of the Sherman Act by fixing the retail prices of drugs and causing some of Blue Shield's policyholders to boycott certain pharmacies that did not participate in the Blue Cross Pharmacy Agreements. 440 U.S. at 207. The issue before the Court was "[w]hether the Court of Appeals was correct in concluding that these Pharmacy Agreements are not the "business of insurance" within the meaning of § 2(b) of the McCarran-Ferguson Act." 440 U.S. at 210. The Court reasoned that the Pharmacy Agreements had nothing to do with the spreading of a policyholder's risk,

but were merely contractual arrangements to help minimize the cost of meeting its promises to its policyholders. As the Court noted, "so long as that promise is kept, policyholders are basically unconcerned with arrangements made with Blue Shield and participating pharmacies." 440 U.S. at 214. The Court also noted that the Pharmacy Agreements were not between the insurer and the insured, but were, instead, "separate contractual arrangements between Blue Shield and pharmacies engaged in the sale and distribution of goods and services other than insurance." 440 U.S. at 216. Finally, the Court thought it was significant that the Pharmacy Agreements involved parties "wholly outside the insurance industry." 440 U.S. at 231.

In contrast to *Royal Drug*, the present case impacts directly on whether the ADIC insureds successfully transferred their risks to an insurer as they intended when they entered into their insurance contract, or whether the full brunt of that risk is going to land on their shoulders due to the insolvency of ADIC. Unlike *Royal Drug*, this is clearly not a case where the "policyholders are basically unconcerned" with the operation of the Ohio insurance insolvency statute. Policyholders are vitally concerned with whether the Ohio statute operates as written to maximize the chance their claims will be paid. Second, the Ohio statute focuses directly on the enforcement of the insurance contract between insurer and insured, rather than an organized series of contracts with third party pharmacies. Third, the State Insurance Insolvency Statute prioritizes claims only against insurance companies, not against parties "wholly outside the insurance industry." 440 U.S. at 231.

Finally, unlike *Royal Drug*, the present case does not involve an attempt to use McCarran-Ferguson to circumvent the requirements of the Sherman Act. This was precisely the point upon which the Court in *Garcia* distinguished *National Securities*, *Royal Drug* and *Pireno*:

[T]he circumstances here are distinguishable from the above mentioned cases. As explained by the Sixth Circuit in *Fabe* . . . "(u)nlike *National Securities*, *Royal Drug* and *Pireno*, this case does not involve a third-party non-insurer seeking to avoid the provisions of federal law through the operation of the McCarran-Ferguson Act. Rather, it concerns a state law designed to protect the interest of the insureds in their relationship with insurers by providing assurances as to the reliability and enforcement of the policies issued."

Garcia at 18a. The Court in *Garcia* and the Court below were both correct in finding a fundamental difference between a practice which a party is attempting to use to avoid liability for a violation of federal law and a practice designed to protect policyholders.

The most recent decision of this Court concerning the meaning of "the business of insurance" is *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982). Union Labor Life Insurance Co. ("ULL") issued health insurance policies that covered chiropractic treatments, provided they were "reasonable" charges for "necessary" medical care. 458 U.S. at 122. As part of its effort to determine what was reasonable and necessary, ULL occasionally sought the opinion of the Peer Review Committee of the New York State Chiropractic Association. 458 U.S. at 123. Some of Pireno's treatments were referred to the Committee, and in certain of those cases the Committee concluded that his charges were not reasonable or his treatments, necessary. 458 U.S. at 123. Pireno sued, alleging that ULL and the Chiropractic Association used the Committee as part of a price fixing scheme in violation of § 1 of the Sherman Act. 458 U.S. at 124. After reviewing this Court's prior decision in *Royal Drug*, the Court stated a 3-part test:

In sum, *Royal Drug*, identified three criteria relevant in determining whether a particular practice is part of the "business of insurance" exempted from the antitrust laws by § 2(b): *first*, whether the practice has the effect of transferring or spreading a policyholder's risk; *second*, whether the practice is an integral part of the policy relationship between the insurer and the insured; and *third*, whether the practice is limited to entities within the insurance industry. None of these criteria is necessarily determinative in itself. . . .[15]

Based on this three-part test, the Court concluded that ULL's use of Chiropractic Peer Review Committee was not exempted from the antitrust laws by McCarran-Ferguson.

The first criterion under *Pireno*, is whether the Ohio insurance priority statute has the effect of transferring or spreading a policyholder's risk. It should be axiomatic that policyholders want and expect to transfer the risk in reality, not just in legal theory. The states have a strong interest in seeing that this reasonable expectation is met. When an insurance company becomes insolvent the question of whether, in fact the risk has been transferred often depends, as a practical matter, on whether the insureds are given a high priority in comparison with the other claimants of the insolvent insurance com-

[15] This brief analyzes the three-part *Pireno* test notwithstanding the fact that, unlike *Pireno*, the question here is not whether the Ohio statute is "exempted from the antitrust laws by § 2(b)." *Pireno* was guided by the fact that "[o]ur precedents consistently hold that exemptions from the antitrust laws must be construed narrowly" (458 U.S. at 126), and no such rule has ever been articulated as to exemptions from the federal priority statute at issue here. Accordingly, the *Pireno* analysis set forth herein is not meant to foreclose any alternative analysis of the scope of McCarran-Ferguson. *See* Howard & Stone, *The United States Versus The Liquidators of Insolvent Insurance Companies*, Insurance Litigation Reporter 467, 470-472 (October 1991). At a minimum, public policy, which has long favored state regulation of insurance, dictates that "the business of insurance" should be construed broadly in the present circumstances.

pany. Unless the insureds are given a high priority, as Ohio does, the concept of spreading or transferring the risk remains just that—a concept.

The United States Treasury Department has noted that insurance companies are becoming insolvent at an increasing rate. Petitioner's Brief at 12. To the extent that this is true, it makes it even more important in this time of financial uncertainty that states be allowed to protect insureds' attempts to transfer risks in reality and not just in theory. The Treasury Department has argued that the financial impact of this case is significant in that there are $10.7 million in federal claims against ADIC, and the federal government is a claimant in many other insolvencies as well. Petitioner's Brief at 12. Admittedly, if the United States Department of Treasury is not allowed to jump ahead in line, its recovery may be reduced. However, the alternative is to send that loss crashing down on the shoulders of the insureds who, through no fault of their own, find their insurance company insolvent. Ohio and virtually all other states have determined that governments are in a better position than individual insureds to absorb and spread out such uncompensated losses. To allow the Treasury Department to leapfrog ahead of the insureds of ADIC would flaunt that determination as well as *Pireno's* concern with transferring or spreading a policyholder's risk. It would result in the risk of loss being concentrated on the unfortunate insureds of ADIC. Certainly, this Court could not have had that result in mind when it issued its decision in *Pireno*. Just as certainly, Congress could not have intended that such a basic and long established insurance regulation as the setting of priorities for claims against insurance companies would not be covered by McCarran-Ferguson.[16]

[16] Finally, the Treasury Department's argument that the "effect on federal revenue would be significant" (Petitioner's Brief at 12) if the federal government is not given a superpriority is belied by Congress' treatment of federal claims under the bankruptcy laws. In bankruptcy claims Congress has granted tax claims a mere seventh priority and other federal claims an even lower status. As one commentator has noted:

> There is no sense in the federal bankruptcy laws, which cover a vastly greater number of cases and could be expected to involve far larger losses to the federal treasury, that the claims of injured workers and consumers of an insolvent business should have their claims debilitated by a special federal priority. Likewise the courts have refused to allow the federal government to assert the priority in national bank insolvencies. The result of this inconsistency in federal treatment of its claims against an insolvent is the potential injury of the very parties Congress (according to the *National Securities* decision) asked the state to protect by the adoption of the McCarran-Ferguson Act.

Darr, *Federal Claims in Insurance Insolvencies*, 25 Tort & Insurance L.J. 601 (1990).

The second *Pireno* criterion is whether the practice is an integral part of the policy relationship between the insurer and the insured. In *Pireno*, ULL's use of the Peer Review Committee was found not to be an integral part of the policy relationship between insurer and insured since the arrangement between ULL and the Committee was "obviously distinct from ULL's contracts with its policyholders." 458 U.S. at 131. This Court further found that the use of the Peer Review Committee was "a matter of indifference to the policyholder whose only concern is *whether* his claim is paid, not *why* it is paid." 458 U.S. at 132 (emphasis in original).

The present case is 180 degrees removed from the facts in *Pireno*. Here the challenged practice is a state law giving a high priority to the claims of insureds so that those insureds are more likely to be paid under their contract with their insurance company. Thus, the Ohio law directly impacts ADIC's contract with its insureds. The Ohio law deals with the most integral part of the contractual relationship between an insured and the in-

surer—whether the policyholder is paid for claims for which the insurance company is admittedly responsible.

Similarly, unlike *Pireno*, the challenged practice—giving priority to policyholders' claims—is most definitely not "a matter of indifference to the policyholder." This Court was absolutely correct in *Pireno* in stating that the policyholder's "only concern is *whether* his claim is paid, not *why* it is paid." 458 U.S. at 132 (emphasis in original). The Ohio law speaks directly to that precise concern and makes it more likely that a policyholder will be paid when his or her insurance company becomes insolvent. While some claims of some insureds are covered (at least in part) by insurance guaranty associations, a large number of claims either are not covered completely or are not covered at all. The only recourse these insureds have is against the liquidator.

The United States Treasury Department wants to twist the Court's assessment of what is at the core of the insured/insurer relationship—whether the insured is paid—and say that this does not matter. The Treasury Department's ~~position~~ flies in the face of common sense and the universal concern of policyholders, recognized by *Pireno*, to be paid by their insurer. This concern is no less valid when the Company encounters financial difficulties. Indeed, this is precisely the time when that concern is the greatest. Ohio and other states have addressed this legitimate concern head-on by enacting statutes that give insureds a high priority among the claims against insolvent insurers. To say that this is a regulation of something other than the business of insurance defies logic and the intent of McCarran-Ferguson.

The final factor to be examined is whether the challenged statute is limited to entities within the insurance agency. In *Pireno*, the challenged practice ran afoul of this test since the use of the Peer Review Committee obviously involved a third party wholly outside of the insurance industry. 458 U.S. at 132. As this Court noted:

> Arrangements between insurance companies and parties outside the insurance industry can hardly be said to lie at the center of that legislative concern [in McCarran-Ferguson]. More importantly, such arrangements may prove contrary to the spirit as well as the letter of § 2(b), because they have the potential to restrain competition in noninsurance markets.

458 U.S. at 133. In the present appeal, by contrast, the Ohio priority scheme applies solely to insolvent insurance companies. The Ohio statute does not purport to cover insolvencies of any other companies or entities. In the matter at hand, there is no third party intimately involved at the center of the practice at issue, such as was true of the Peer Review Committee in *Pireno* and the participating pharmacies in *Royal Drug*. Unlike *Pireno* this case does not involve "arrangements between insurance companies and parties outside the insurance industry." Furthermore, in contrast to *Pireno* this is not a case where the challenged practice "may prove contrary to the spirit as well as the letter of § 2(b), because they have the potential to restrain competition in noninsurance markets." Thus, the factors that concerned the Court in *Pireno* are simply not present here.

The Treasury Department argues that others outside the insurance industry are involved insofar as they have claims against the insolvent insurance companies. This argument is without merit for two reasons. First, the argument proves too much. The Treasury Department has adopted an unreasonably broad interpretation of whether the practice is limited to entities within the insurance industry. To some extent any law can be said to indirectly impact or involve third parties; but that is not the issue. The correct question is whether there is the type of major involvement as was true of the Peer Review Committee in *Pireno* and the participating pharmacies in *Royal Drug*. Clearly, that is not the case in the present appeal. Second, even if by some stretch of lan-

guage it could be said that the Ohio statute was not limited to entities within the insurance industry, the fact remains that the challenged practice "need not be denied the § 2(b) exemption *solely* because they involve parties outside the insurance industry." 458 U.S. at 133.[17] In short, the third part of the *Pireno* test is fully satisfied by the Ohio insurance insolvency priority statute.

In sum, the Ohio insurance priority statute at issue is within the ambit of the McCarran-Ferguson Act no matter how one analyzes the issue. McCarran-Ferguson protects the states' right to enact laws to regulate "the business of insurance." The plain and unambiguous meaning of that term includes a statute intended to make it more likely, in the event of an insolvency, that policyholders' claims are paid. Furthermore, based on the *National Securities-Royal Drug-Pireno* trilogy, the decision of the Sixth Circuit should be affirmed: 1. The Ohio law has the very practical and real effect of helping to spread the policyholders' risk. 2. The Ohio statute makes more reliable and enforceable the most integral part of the policy relationship between insurer and insured—whether the policyholder's claim is paid. 3. The Ohio law prioritizes only the claims against insolvent insurers.

[17] *See also* 458 U.S. at 129 ("None of these criteria is necessarily determinative in itself . . . .")

CONCLUSION

For the reasons set forth above, the judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

F. JAMES FOLEY
Counsel of Record
VORYS, SATER, SEYMOUR AND PEASE
52 East Gay Street
P.O. Box 1008
Columbus, Ohio 43216-1008
(614) 464-5411
Attorney for Amici Curiae
National Conference of Insurance Guaranty Funds and National Organization of Life & Health Insurance Guaranty Associations

September, 1992

APPENDICES

APPENDIX A

STATUTORY PROVISIONS INVOLVED

1. The federal priority statute, 31 U.S.C. 3713, provides:

   Priority of Government claims

   (a)(1) A claim of the United States Government shall be paid first when—

   (A) a person indebted to the Government is insolvent and—

   (i) the debtor without enough property to pay all debts makes a voluntary assignment of property;

   (ii) property of the debtor, if absent, is attached; or

   (iii) an act of bankruptcy is committed; or

   (B) the estate of a deceased debtor, in the custody of the executor or administrator, is not enough to pay all debts of the debtor.

   (2) This subsection does not apply to a case under title 11.

   (b) A representative of a person or an estate (except a trustee acting under title 11) paying any part of a debt of the person or estate before paying a claim of the Government is liable to the extent of the payment for unpaid claims of the government.

2. The McCarran-Ferguson Act, 15 U.S.C. 1011-1012, provides in part:

   § 1011. Declaration of policy

   Congress hereby declares that the continued regulation and taxation by the several States of the busi-

ness of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.

§ 1012. Regulation by state law; Federal law relating specifically to insurance; applicability of certain Federal laws after June 30, 1948

(a) State regulation

The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

(b) Federal regulation

No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance * * * unless such Act specifically relates to the business of insurance.

3. The Ohio Insurers Supervision, Rehabilitation and Liquidation Act, Ohio Rev. Code Ann. §§ 3903.21 (A)(2), 3903.21(A)(3), 3903.21(A)(4), 3903.21 (A)(12), 3903.32, 3903.33 and 3903.42 (Anderson 1989 & Supp. 1991) provide:

§ 3903.21 Powers of liquidator

(A) The liquidator may do any of the following:

* * *

(2) Employ employees and agents, actuaries, accountants, appraisers, consultants, and such other personnel as he may consider necessary to assist in the liquidation;

(3) Fix the reasonable compensation of employees and agents, actuaries, accountants, appraisers, and consultants with the approval of the court;

(4) Pay reasonable compensation to persons appointed and defray from the funds or assets of the insurer all expenses of taking possession of, conserving, conducting, liquidating, disposing of, or otherwise dealing with the business and property of the insurer. In the event that the property of the insurer does not contain sufficient cash or liquid assets to defray the costs incurred, the superintendent of insurance may advance the costs so incurred out of any appropriation for the maintenance of the department of insurance. Any amounts so advanced for expenses of administration shall be repaid to the superintendent for the use of the department out of the first available money of the insurer.

* * * *

(12) Continue to prosecute and to commence in the name of the insurer or in his own name any and all suits and other legal proceedings, in this state or elsewhere, and to abandon the prosecution of claims he considers unprofitable to pursue further. If the insurer is dissolved under section 3903.20 of the Revised Code, he shall have the power to apply to any court in this state or elsewhere for leave to substitute himself for the insurer as plaintiff.

§ 3903.32 Recovery from reinsurers

The amount recoverable by the liquidator from reinsurers shall not be reduced as a result of delinquency proceedings, regardless of any provision in the reinsurance contract or other agreement. Payment made directly to an insured or other creditor does not diminish the reinsurer's obligation to the insurer's estate except when the reinsurance contract provides for direct coverage of a named insured and the payment is made in discharge of that obligation.

§ 3903.33 Payment of unpaid earned premiums

(A) an agent, broker, premium finance company, or any other person, other than the insured, responsible for the payment of a premium is obligated to pay any unpaid earned premium due the insurer at the time of the declaration of insolvency, as shown on the records of the insurer. The liquidator may recover from such person any part of an unearned commission of such person.

(B) An insured shall be obligated to pay any unpaid earned premium due the insurer at the time of the declaration of insolvency, as shown on the records of the insurer.

§ 3903.42 Priority of distribution of claims

The priority of distribution of claims from the insurer's estate shall be in accordance with the order in which each class of claims is set forth in this section. Every claim in each class shall be paid in full or adequate funds retained for such payment before the members of the next class receive any payment. No subclasses shall be established within any class. The order of distribution of claims shall be:

(A) Class 1. The costs and expenses of administration, including but not limited to the following:

(1) The actual and necessary costs of preserving or recovering the assets of the insurer;

(2) Compensation for all services rendered in the liquidation;

(3) Any necessary filing fees;

(4) The fees and mileage payable to witnesses;

(5) Reasonable attorney's fees;

(6) The reasonable expenses of a guaranty association or foreign guaranty association in handling claims.

(B) Class 2. Debts due to employees for services performed to the extent that they do not exceed one thousand dollars and represent payment for services performed within one year before the filing of the complaint for liquidation. Officers and directors shall not be entitled to the benefit of this priority. Such priority shall be in lieu of any other similar priority that may be authorized by law as to wages or compensation of employees.

(C) Class 3. All claims under policies for losses incurred, including third party claims, all claims against the insurer for liability for bodily injury or for injury to or destruction of tangible property that are not under policies, and all claims of a guaranty association or foreign guaranty association. All claims under life insurance and annuity policies, whether for death proceeds, annuity proceeds, or investment values, shall be treated as loss claims. That portion of any loss, indemnification for which is provided by other benefits or advantages recovered by the claimant, shall not be included in this class, other than benefits or advantages recovered or recoverable in discharge of familial obligations of support or by way of succession at death or as proceeds of life insurance, or as gratuities. No payment by an employer to an employee shall be treated as a gratuity. Claims under nonassessable policies for unearned premium refunds.

(D) Class 4. Claims of general creditors.

(E) Class 5. Claims of the federal or any state or local government. Claims, including those of any governmental body for a penalty or forfeiture, shall be allowed in this class only to the extent of the pecuniary loss sustained from the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby. The remainder of such claims shall be post-

poned to the class of claims under division (H) of this section.

(F) Class 6. Claims filed late or any other claims other than claims under divisions (G) and (H) of this section.

(G) Class 7. Surplus or contribution notes, or similar obligations, and premium refunds on assessable policies. Payments to members of domestic mutual insurance companies shall be limited in accordance with law.

(H) Class 8. The claims of shareholders or other owners.

4. The Ohio Insurance Guaranty Association Act, Ohio Rev. Code Ann. § 3955.06(A) (Anderson Supp. 1991) provides:

§ 3955.06 Creation of nonprofit association

(A) There is hereby created a nonprofit unincorporated association to be known as the Ohio Insurance Guaranty Association. All members insurers, as defined in division (D) of section 3955.01 of the Revised Code, shall be and remain members of the association as a condition of their authority to transact insurance in this state. The association shall perform its functions under a plan of operation established and approved under section 3955.09 of the Revised Code and shall exercise its powers through a board of directors established under section 3955.07 of the Revised Code.

5. The Ohio Life and Health Insurance Guaranty Association Act, Ohio Rev. Code Ann. § 3956.06 (Anderson Supp. 1991) provides:

§ 3956.06 Life and health insurance guaranty association created; life insurance and annuity account; health insurance account; supervision.

(A) There is hereby created a nonprofit unincorporated association to be known as the Ohio life and health insurance guaranty association. All member insurers shall be and remain members of the association as a condition of their authority to transact the business of insurance in this state. The association shall perform its functions under the plan of operation established and approved under section 3956.10 of the Revised Code and shall exercise its powers through a board of directors established under section 3956.07 of the Revised Code. For purposes of administration and assessment, the association shall maintain the following two accounts:

(1) The life insurance and annuity account which includes the following subaccounts:

(a) Life insurance subaccount;

(b) Annuity subaccount;

(c) Unallocated annuity subaccount which also includes all annuity contracts meeting the requirements of section 403(b) of the "Internal Revenue Code of 1986," 100 Stat. 2085, 26 U.S.C. 1, as amended.

(2) The health insurance account.

(B) The association is subject to the supervision of the superintendent of insurance and to the applicable insurance laws of this state.

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF IOWA
CENTRAL DIVISION

Civil No. 4-91-10209

DAVID J. LYONS, Commissioner of Insurance for the State of Iowa, as Liquidator of Carriers
Plaintiff,

vs.

UNITED STATES OF AMERICA,
Defendant.

Before the court for ruling is plaintiff's motion for summary judgment filed December 5, 1991. The government resisted on March 19, 1992. Plaintiff filed his reply on April 3, 1992.

BACKGROUND

Plaintiff, the Iowa Insurance Commissioner, instituted the present lawsuit as liquidator for the insolvent Carriers Insurance Co., (Carriers) contesting an IRS determination that in 1980, Carriers illegally changed accounting methods. The IRS determined this illegal change resulted in an underreporting of income, and as a consequence assessed Carriers with additional tax liability. In 1982, Carriers experienced an operating loss entitling it to a business-loss carry back to 1980. The 1982 loss carry back was not sufficient to cover the entire amount of tax and interest due, however, and the liability not extinguished by the carry back continued to accrue interest until March, 1991 when the total amount due was

paid. Plaintiff then instituted this suit seeking a refund.

The parties have settled one of the two issues presented for summary judgment as the United States has agreed to refund the interest which accrued after Carriers was declared insolvent. The remaining issue focuses on which priority statute governs the distribution of assets of an insolvent insurance company. More specifically, should Iowa law or federal law determine creditor priority.

APPLICABLE LAW AND DISCUSSION

Preliminarily, the court notes that this matter is before it on plaintiff's motion for summary judgment, and summary judgment is "clearly appropriate where the court is faced with a motion . . . for summary judgment, wherein all parties admit to undisputed facts and are merely seeking a declaration of the law." *Gordon v. United States Dept. of Treasury*, 668 F. Supp. 483, 487 (D.Md. 1987). The parties in this case have stipulated to the facts and are seeking a declaration from this court of which law will decide insolvent insurer creditor priority. The issue is ripe for summary judgment.

A. JURISDICTIONAL ISSUE

The United States initially urges that this court lacks jurisdiction to consider the remaining summary judgment issue because plaintiff has sought relief under 28 U.S.C. § 2201, the Declaratory Judgment Act. The Act provides that a court may declare rights in any case of actual controversy within its jurisdiction except with respect to federal taxes other than actions brought under § 7428.[1]

The government's jurisdictional argument is flawed. The declaratory relief sought in count II of plaintiff's

---

[1] 26 U.S.C. § 7428 provides for declaratory judgments relating to status and classification of organizations under sections 501(c)(3), 509(a) and 4942(j)(3).

amended complaint is a separate and distinct issue from the request for a tax refund in count I. In count II, the plaintiff seeks a declaration regarding which law governs creditor priority for insolvent insurance companies. The exception in § 2201 regarding federal taxes is inapplicable in this instance because the declaratory relief sought does not relate to federal taxes even though resolution of the issue in favor of plaintiff may, as a practical matter, render the count I tax refund claim moot.

Rather, count II presents an actual controversy within this court's jurisdiction involving the interrelationship of the McCarran-Ferguson Act, the Federal Insolvency Statute and the Iowa priority statute.[2] As acknowledged by the government's counsel during oral argument, plaintiff is entitled to a federal forum to resolve this issue. The controversy falls within this court's subject matter jurisdiction, and the court may properly consider declaratory relief regarding it. The real issue is whether a determination of the statutory interrelationship issue should be deferred pending resolution of the tax controversy. The court finds that there should be no deferral.

B. McCARRAN-FERGUSON ACT

The regulation of the "business of insurance" has been delegated to the individual states by the McCarran-Ferguson Act:

> The business of insurance, and every person engaged therein, shall be subject to the laws of the several states which relate to the regulation or taxation of such business.
>
> No act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any state for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such act specifically relates to the business of insurance: Provided, that [the Sherman Act, Clayton Act and Federal Trade Commission Act] shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

[2] Iowa Insurers Supervision Rehabilitation and Liquidation Act, Iowa Code § 507C.42.

15 U.S.C. § 1012(a) & (b).

Plaintiff claims that part of regulating the "business of insurance" is determining the priority of payment among creditors of insolvent insurance companies and that the Iowa insurance priority statute is controlling. In addressing priority, the statute specifies five classes of creditors with payment for federal taxes ranking last. In contrast, the United States maintains that creditor priority should be determined by an application of the Federal Insolvency Statute, 31 U.S.C. § 3713, which places tax collection at the top of the priority list. The government contends that the McCarran-Ferguson Act does not apply because this case does not involve the regulation of the "business of insurance," a phrase that has been narrowly defined by the Supreme Court.

The Supreme Court in two antitrust cases set out a test to determine if an activity regulated by the state is to be considered the "business of insurance" within the meaning of the McCarran-Ferguson Act. *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205 (1979); *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982). The Court found three criteria relevant in determining whether a particular practice is part of the "business of insurance" exempted from the anti-trust laws by § 2(b) of the McCarran-Ferguson Act: (1) whether the practice has the effect of transferring or spreading a policyholder's risk; (2) whether the practice is an integral part of the policy relationship between the insurer and the insured; and (3) whether the practice is limited to entities within the insurance industry. *Pireno*, 458 U.S. at 126-129.

Three circuit court decisions have addressed the question of whether state or federal law should determine the priority of creditors of insolvent insurance companies. Two cases decided in 1988 by the Ninth and Fourth Circuits favor the government's position and hold that the Federal Insolvency Statute preempts the states' insurance priority statutes. *Gordon v. United States Department of Treasury*, 846 F.2d 272 (4th Cir. 1988); *State of Idaho ex rel. Soward v. United States*, 858 F.2d 445 (9th Cir. 1988). A 1991 Sixth Circuit case held that the state insurance statute properly regulated the priority of creditors of an insurance company and was within the definition of the business of insurance according to the McCarran-Ferguson Act. *Fabe v. United States Department of Treasury*, 939 F.2d 341 (6th Cir. 1991). The court in *Fabe* applied the three-part test set forth in *Pireno* to determine the scope of the phrase, "the business of insurance." The Eighth Circuit has not yet considered this issue.

There are also several federal courts that have abstained from exercising federal jurisdiction in cases involving state insurance liquidation priority schemes on McCarran-Ferguson grounds. *See e.g., Grimes v. Crown Life Ins. Co.*, 857 F.2d 699 (10th Cir. 1988) (court abstains declaring receivership regulations are laws concerning the "business of insurance"); *Levy v. Lewis*, 635 F.2d 960 (2d Cir. 1980) (court abstains in case involving conflict between state insurance liquidation statute and ERISA); *Washburn v. Corcoran*, 653 F. Supp. 554 (S.D.N.Y. 1986) (court abstains in conflict between Federal Arbitration Act and New York law regulating the liquidation of domestic insurance companies). The *Fabe* court found these abstention cases persuasive even though they did not apply the *Pireno* three-part analysis to determine if the act of liquidation was to be considered the "business of insurance" according to McCarran-Ferguson.

This is a difficult question. There are strong public policy arguments on both sides. Usually federal law is

supreme, but Congress has carved out a niche for states to regulate insurance companies through the McCarran-Ferguson Act. In addition, Congress has specifically exempted insurance companies from liquidation under the federal bankruptcy code, 11 U.S.C. § 109, and have entrusted the liquidation of insolvent insurance companies to the states.

The focus of the McCarran-Ferguson Act is on protecting policyholders. In *National Securities & Exchange Commission v. National Securities*, 393 U.S. 453 (1969), the Supreme Court stated,

> whatever the exact scope of the statutory term, [the "business of insurance"], it is clear where the focus [of the McCarran-Ferguson Act] was—it was on the relationship between the insurance company and the policyholder. Statutes aimed at protecting this relationship, directly or indirectly, are laws regulating the "business of insurance."

National Securities, 393 U.S. at 460. The Sixth Circuit in *Fabe*, observed that "it is clear from the language and operation of [Ohio's Insolvent Insurer's statute] that its focus is the protection of insureds by diverting the scarce resources of the liquidated entity away from any non-insured creditors, toward policyholders." Iowa's insolvent insurer's statute is similarly focused. After carefully examining the cases previously cited, the court concurs with the reasoning in Judge Martin's opinion in *Fabe* and concludes that a state's insolvent insurer's statute regulates activities falling within the definition of the "business of insurance" as required in the McCarran-Ferguson Act.[3]

[3] In discussing the meaning of the "business of insurance," the *Fabe* court held that the three-factor test that determines what constitutes the "business of insurance" as set forth in *Pireno* and *Royal Drug* applied to non-antitrust situations. *Pireno* and *Royal Drug* involved antitrust claims.

An alternative approach is suggested by Davis Howard's article, *Uncle Sam Versus the Insurance Commissioners: A Multi-Level*

CONCLUSION AND ORDER FOR JUDGMENT

IT IS ORDERED that summary judgment shall be entered on count II in favor of the plaintiff, declaring that the Iowa Insurers Supervision Rehabilitation and Liquidation Act, Iowa Code § 507C.32 is a state law regulating the business of insurance within the meaning of the McCarran-Ferguson Act, 15 U.S.C. § 1012.

Dated this 2nd day of July, 1992.

/s/ Ronald E. Longstaff
RONALD E. LONGSTAFF
Judge
United States District Court

Approach to Defining the "Business of Insurance" under the McCarran-Ferguson Act, 25 Willamette L. Rev. 1 (1989). This court finds the multi-definitional analysis advocated in Howard's article to be intriguing and perhaps preferable to the tripartite *Pireno* analysis on the issue of defining the "business of insurance" in nonantitrust cases. The author suggests applying the test set forth in *National Securities* to determine what constitutes the business of insurance, and proposes a broadening of the defintion in superpriority cases. The court found no case adopting the author's position.

UNITED STATES DISTRICT COURT
D. PUERTO RICO

Civil No. 91-1679 (GG)

JUAN ANTONIA GARCIA, in his Capacity as Insurance Commissioner Puerto Rico,
Plaintiff,

vs.

ISLAND PROGRAM DESIGNER, INC.,
Defendant.

OPINION AND ORDER

GIERBOLINI, Chief Judge

This case requires us to rule on the issue of whether the liquidation proceedings of an insurance company initiated in the Superior Court of Puerto Rico by the Insurance Commissioner in his official capacity, qualifies as "business of insurance" as defined under the McCarran-Ferguson Act.[1] We also need to decide if under the McCarran-Ferguson Act, the Puerto Rico Insurance Code[2] takes precedence over the federal superpriority statute.[3] Procedurally, the case is before us pursuant to a motion to remand filed by the Commissioner after the Internal Revenue Service filed a notice to remove the case to this court.[4]

[1] 15 U.S.C. § 1011 et seq. (1988).

[2] 26 L.P.R.A. § 4001 et seq.

[3] 31 U.S.C. § 3713(a)(1)(A).

[4] 28 U.S.C. § 1441(b).

I. BACKGROUND

The facts in this case are uncontested. The Puerto Rico Insurance Commissioner, in his capacity as receiver to distribute the assets of an insolvent Health Maintenance Organization ("HMO"), ISLAND Program Designer ("IPD"), commenced judicial proceedings in Superior Court of Puerto Rico, Bayamon Part, pursuant to the provisions of Chapter 40 of the Insurance Code of Puerto Rico, 26 L.P.P.A. § 4001 et seq.[5] On January 8, 1988, the local court entered an order extending the deadline to submit claims against the assets of IPD up to and including May 19, 1988. On June 1, 1989, the IRS filed its claims in the Office of the Insurance Commissioner of Puerto Rico. On July 5, 1990, the Insurance Commissioner filed in Superior Court a listing of the priority of claims submitted in the IPD's liquidation. Thereafter, he amended the list of priority claims and, clarified that only the claims filed prior to May 19, 1988, would be considered as timely filed.

The IRS, after receiving permission by the Superior Court, intervened in the case on May 24, 1991, seeking to collect monies owed by the insolvent insurer. The IRS claimed a preference with respect to all other parties, including policyholders, subscribers, providers of services, beneficiaries and insureds, pursuant to 31 U.S.C. § 3713 (a)(1)(A) (federal priority statute).[6] On May 28, 1991, the IRS filed a Notice of Removal to this court.

Plaintiff avers that the federal super-priority statute does not apply to the liquidation proceedings under the Puerto Rico Insurance Code, because the proceedings are

[5] Civil No. CS 87-509, Superior Court of Puerto Rico, Bayamon Part.

[6] 31 U.S.C. § 3713 provides as follows in the pertinent part: (a)(1) A claim of the United States shall be paid first when: (A) a person indebted to the Government is insolvent and—(i) a debtor without enough property to pay all assignment of debts makes a voluntary assignment of property; (ii) property of the debtor is absent, is attached, or (iii) an act of bankruptcy is committed(.)

part of the "business of insurance" within the purview of the McCarran-Ferguson Act. Accordingly, he argues that Article 40.190, 26 L.P.R.A. § 4019, takes precedence over the federal priority statute, and is therefore not preempted by 31 U.S.C. § 3713, as claimed by the IRS. He further asserts that abstention under the doctrine of *Burford v. Sun Oil Co.*, 319 U.S. 315, 63 S.Ct. 1098, 87 L.Ed. 1424 (1943), is proper because interpretation of a complex and specialized statute drafted to govern the insurance business in Puerto Rico is at issue here.

II. DISCUSSION

(1) As mentioned above, the first issue is whether the liquidation proceedings of an insolvent insurer are part of the "business of insurance" pursuant to the McCarran-Ferguson Act.

Facing similar circumstances, our Circuit in *Gonzalez v. Media Elements, Inc.*, 946 F.2d 157 (1st Cir. 1991) found that federal abstention was appropriate under the doctrine of *Burford v. Sun Oil Co.*, 319 U.S. 315, 63 S.Ct. 1098 (1943). In *Gonzalez*, the First Circuit set forth the policy for us to consider in considering to remand these causes of action:

By enacting the Uniform Insurers Liquidation Act, 26 L.P.R.A. § 4001 et seq., Puerto Rico has constructed a comprehensive framework for the liquidation of insolvent insurance companies and the resolution of claims against them. Continued federal litigation may disrupt Puerto Rico's regulatory system in three significant ways: (1) by taking jurisdiction away from the "central administration forum" in which Puerto Rico's legislature intended to concentrate all 'claims against the corporation being liquidated, a method that promotes the orderly adjudication of same.' *Calderon v. Commonwealth Insurance Co.*, 111 D.P.R. 153 (1981); (2) by forcing the Puerto Rico Insurance Commissioner to dissipate the insolvent insurer's funds litigating a claim that could be

settled more efficiently in the administrative forum; and (3) by creating the risk that Puerto Rico and the federal court will adopt different interpretations of the policy term at issue here, thus defeating the Commonwealth's interest in a consistent disposition of all claims against the insolvent insurer. *Id.* at 157. (Citations omitted.)

The intervenor's assertion that the liquidation proceedings are not part of the "business of insurance" or in the alternative, that the federal super-priority statute preempts any state priority statute is not availing and runs contrary to *Gonzalez v. Media Elements, Inc.* IRS cites the trilogy of Supreme Court cases interpreting the "business of insurance" under the McCarran-Ferguson Act: *Union Labor Life Insurance Co. v. Pireno*, 458 U.S. 119, 102 S.Ct. 3002, 73 L.Ed.2d 647 (1982); *Group Life & Health Insurance Co. v. Royal Drug Co.*, 440 U.S. 205, 99 S.Ct. 1067, 59 L.Ed.2d 261 (1979); and *SEC v. National Securities, Inc.*, 393 U.S. 453, 89 S.Ct. 546, 21 L.Ed.2d 668 (1969). However, the circumstances here are distinguishable from the above mentioned cases. As explained by the Sixth Circuit in *Fabe v. U.S. Dept. of Treasury*, 939 F.2d 341 (6th Cir. 1991): "(u)nlike *National Securities*, *Royal Drug*, and *Pireno*, this case does not involve a third-party noninsurer seeking to avoid the provisions of federal law through the operation of the McCarran-Ferguson Act. Rather, it concerns a state law designed to protect the interest of the insureds in their relationship with insurers by providing assurances as to the reliability and enforcement of the policies issued. See *National Securities*, 393 U.S. at 460 (89 S.Ct. at 568)." *Id.* at 351. The cases of *State of Idaho ex rel. Soward v. United States*, 858 F.2d 445 (9th Cir. 1988); and *Gordon v. United States Dept. of Treasury*, 846 F.2d 272 (4th Cir. 1988) are in conflict with *Gonzalez v. Media Elements, Inc.*, of the First Circuit cited above. Those cases also addressed the particular issue raised here and rejected the argument that states' liquidation

priority statutes regulated the "business of insurance" within the scope of McCarran-Ferguson Act.

With deference to the Fourth and Ninth Circuits we follow the precedent established in 1991 by our Circuit in *Gonzalez*, that explicitly found those liquidation proceedings of an insolvent insurer under the Puerto Rico Insurance Code, are part of the "business of insurance". This ruling governs the instant case not only because it is a First Circuit case, but also because it specifically deals with the point at issue here. We only add that those cases failed to discuss whether the federal statute supersedes or not the McCarran-Ferguson Act.

This is not the end of our inquiry, since we must now resolve the second issue of whether the federal super-priority statute, supersedes the McCarran-Ferguson Act. The state law at issue here is the Puerto Rico Insurance Code, and intricate an highly specialized administrative system, adopted by the Commonwealth of Puerto Rico to regulate the life of insurance companies from incorporation to dissolution pursuant to the McCarran-Ferguson Act. Chapter 40 of this code provides a comprehensive program for the rehabilitation and liquidation of domestic insurance companies in Puerto Rico and includes the Uniform Insurers Liquidation Act, contained in sections 4008 to 4014. Said regulation is crucial for consumer protection because insurance companies are not subject to federal bankruptcy proceedings. For this reason, federal courts have often abstained from considering such causes of action, in deference to the state's interest in this matter. See *Fabe, supra*, 939 F.2d at 346-47; citing *Grimes v. Crown Life Insurance Co.*, 857 F.2d 699 (10th Cir. 1988), *cert. denied*, 489 U.S. 1096, 109 S.Ct. 1568, 103 L.Ed.2d 934 (1989). The purpose of the Puerto Rico's Liquidation Priority Statute is to provide a uniform procedure for the Commissioner to request the liquidation of the assets of insolvent insurance companies in Superior Court of Puerto Rico, under several grounds set

forth in the statute. 26 L.P.R.A. § 4002 (Article 40.02). Section 4012 of the statute, establishes the priorities for payment of claims, as defined by section 4007. Under § 4012, all claims submitted against an insolvent insurance company are prioritized.[7] Furthermore, § 4019 of the Liquidation Proceedings statute provides the period of time in which the submission of claims against the insolvent insurer are allowed. This statutory section provides that after the insurer is finally declared insolvent, regardless of any prior notice given to potential creditors, "the Commissioner shall notify all persons who may have claims against such insurer and who have not filed proper proofs thereof, to present the same to him, at a place specified in such notice, within four months from the date of the entry of such order, or, if the Commissioner shall certify that it is necessary, within such longer time as the court may prescribe . . ." 26 L.P.R.A. § 4019(1). Additionally, this section also provides that filing the correspondent proofs of claim after the deadline, will not share in the distribution of assets until all the allowed claims have been paid in full. 26 L.P.R.A. § 4019(2). The deadine for filing claims against IPD was extended up to, and including May 9, 1988. It was not until June 1, 1989, more than a year after the deadline had passed, that the IRS filed its claims with the Office of the Insurance Commissioner of Puerto Rico. On August 7 ,1990, the Commissioner filed a list of the priority claims, specifying that only the claims filed before May 19, 1988, would be considered timely. Claims filed after said deadline, would be considered after all the allowed claims have been paid in full, pursuant to 26 L.P.R.A. § 4019(2). When the IRS ascertained that it would lose the preferred claim status bestowed by federal law and provided for in Chapter 40 of the Puerto

[7] 26 L.P.R.A. § 4007(9) provides that a "preferred claim means any claim with respect to which the law of a state or of the United States accords priority of payment from the general assets of the insurer." (Emphasis ours).

Rico Insurance Code, they moved to remove this action pursuant to 31 U.S.C. § 3179(a)(1)(A), contending that the federal super-priority statute preempts the local statute. As to this contention, the Sixth Circuit has established that "(v)arious statutes enacted by Congress, including the Sherman Act, Clayton Act, and the Federal Trade Commission Act, have been amended as to establish federal dominance in certain areas pursuant to the McCarran-Ferguson Act. Nevertheless, 31 U.S.C. § 3173, the federal superiority statute has not been amended to that effect." *Fabe, supra,* at 344 (n.2). (Emphasis Added). Because our Circuit has not expressed itself on this issue, we are hereby adopting the Sixth Circuit's position in *Fabe, supra,* as persuasive and find that Puerto Rico's liquidation priority statute is not preempted by the federal super-priority statute.

III. CONCLUSION

The McCarran-Ferguson Act and the case law of our Circuit direct us to remand this matter to the local forum in deference to the highly specialized and comprehensive procedure for the liquidation of insolvent insurance companies contained in the Puerto Rico Insurance Code.

WHEREFORE, in view of the forgoing reasons, the instant action must be and is hereby REMANDED to Superior Court of Puerto Rico, Bayamon Part.

SO ORDERED.

No. 91-1513

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

UNITED STATES DEPARTMENT OF THE TREASURY AND
MITCHELL A. LEVINE,
ASSISTANT COMMISSIONER,

Petitioners,

v.

GEORGE FABE, SUPERINTENDENT OF INSURANCE,
STATE OF OHIO,

Respondent.

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

**AMICUS CURIAE BRIEF OF
JAMES A. GORDON, SPECIAL DEPUTY
STATE INSURANCE COMMISSIONER OF MARYLAND
FOR RESPONDENT**

Paul W. Grimm*
Mary Alice McNamara
Gina M. Harasti
NILES, BARTON & WILMER
111 S. Calvert Street
1400 Legg Mason Tower
Baltimore, Maryland 21202
(410) 783-6300

**Counsel of Record for Amicus Curiae*

43

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases: Page

Cases - Continued: Page

No. 91-1513

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1992

UNITED STATES DEPARTMENT OF
THE TREASURY AND MITCHELL A. LEVINE,
ASSISTANT COMMISSIONER, PETITIONERS

v.

GEORGE FABE, SUPERINTENDENT OF INSURANCE,
STATE OF OHIO, RESPONDENT

ON WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE SIXTH CIRCUIT

**AMICUS CURIAE BRIEF OF
JAMES A. GORDON, SPECIAL DEPUTY
STATE INSURANCE COMMISSIONER OF MARYLAND
FOR RESPONDENT**

INTEREST OF THE AMICUS CURIAE

Amicus Curiae, James A. Gordon, a Special Deputy State Insurance Commissioner of Maryland, with powers derived from the Maryland Insurance Code, Md. Ann. Code art. 48A, §§ 133(5), 145, files this Amicus Curiae brief in support of the Respondent. Mr. Gordon is Receiver for Eastern Indemnity Company of Maryland and other insolvent insurance companies in Maryland. Mr. Gordon's interest in this matter originates from his role as plaintiff/appellant in <u>Gordon v. United States Dep't. of the Treasury</u>, 668 F. Supp. 483 (D. Md. 1987), <u>aff'd</u>, 846 F.2d 272 (4th Cir.), <u>cert. denied</u>, 488 U.S. 954 (1988), and continues to the present due to his status as Receiver for other insolvent insurance companies in the State of Maryland.

The primary purpose of Congress in enacting the McCarran-Ferguson Act, 15 U.S.C. §1011 et seq., was to ensure that the regulation of the business of insurance remained a matter of state - not federal - law and that state regulation would be accomplished without federal interference. As this Court has itself recognized, one of the important goals of state insurance regulation is ensuring the solvency of insurance companies. Securities and Exchange Commission v. Variable Annuity Life Ins. Co. of America, 359 U.S. 65, 77 (1959) (Brennan, J., concurring). Indeed, insurance is nothing more than a promise of future payments upon the occurrence of a covered loss, a promise which is completely empty unless the company is viable enough to pay claims at the time of loss. The comprehensive regulatory procedures of the Maryland Insurance Code, like those in

virtually every other state, are aimed at fulfilling the promise of insurance by seeing to it that claims of policyholders, insureds and beneficiaries receive priority payment in the event of insurer insolvency. These state regulations, therefore, enable policyholders to receive the benefits promised by their insurance policies when they otherwise would not, because of the insolvency of the company. Because the ability of an insurer to pay a covered claim is at the heart of the relationship between the insurer and the insured,[1] state insurance code liquidation provisions, designed to assure the reliability and enforcement of insurance policies, do regulate the "business of

1/ Union Labor Life Ins. Co. v. Pireno, 458 U.S. 119, 132 (1982) (policyholder's "only concern is whether his claim is paid, not why it is paid.").

insurance" and, accordingly, come within the aegis of the McCarran-Ferguson Act's prohibition against federal interference. No greater interference can be imagined than that worked by the federal "super priority" of 31 U.S.C. §3713.

Finally, Mr. Gordon's interest in this case as amicus curiae stems from the existing serious uncertainty with respect to the definition of the term "business of insurance," as it is used in the McCarran-Ferguson Act. This uncertainty exists because the decisions of this Court interpreting the McCarran-Ferguson Act have not squarely construed the primary purpose of the Act in thirty years. Instead, this Court's recent decisions construing the Act have been confined to the altogether different and secondary antitrust exemption

purpose, without clarifying the limited nature of these decisions. Consequently, Mr. Gordon recognizes the need for prompt guidance from this Court to lower federal courts which are ever-increasingly struggling with this important issue.

SUMMARY OF ARGUMENT

A.1. Resolution of the issues presented in this case turns on the meaning of the phrase "business of insurance" which is used, but not defined, in the McCarran-Ferguson Act. The legislative history of the McCarran-Ferguson Act demonstrates congressional concern over insurer insolvency. An insurer's ability to pay its policyholders' claims was considered by Congress to be the "business of insurance" when the Act was passed. In essence, the solvency of the insurer is critical to an insurer fulfilling its promise to pay the policyholder upon the happening of a certain

event. See 91 Cong. Rec. 1481 (1945); 90 Cong. Rec. 6526, 6564-65 (1944).

2. Learned treatises also provide well-reasoned analyses of the meaning of the phrase "business of insurance." The payment of losses to policyholders, even in the event of insolvency of the insurer, has been called the raison d'etre of insurance. 2 G. Richards, The Law of Insurance, §207, Selection and Control of the Risk (5th ed. 1952). Scholars consistently link the assumption of the risk factor with the payment of claims once filed, theorizing that without both of these factors insurance does not exist. Thus, it has been repeatedly expressed in insurance treatises that the goal of insurance regulation is the solvency of insurers. State regulatory procedures designed to fulfill the fundamental goals of insurance through the priority payment of policyholder claims when

an insurer becomes insolvent is most decidedly the "business of insurance."

B. Federal courts have directly addressed what activity constitutes the "business of insurance" under the McCarran-Ferguson Act, in cases involving state insurance liquidation receiverships. In deciding whether abstention is appropriate pursuant to Burford v Sun Oil Co., 319 U.S. 315 (1943), these courts consistently respect the comprehensive frameworks enacted by the states to regulate the liquidation of insolvent insurers and the payment of claims against them. The McCarran-Ferguson Act's delegation of insurance regulation to the states has been held to cover state regulation of insolvent insurance companies. Federal Court deference to comprehensive state regulation for insurance company liquidations is probative of the general understanding and interpretation

given to the McCarran-Ferguson Act's phrase "business of insurance."

C. The McCarran-Ferguson Act promotes two distinct purposes. The broad, primary purpose was to continue state regulation of the business of insurance. Group Life & Health Ins. Co. v. Royal Drug Co., 440 U.S. 205 (1979). The secondary, and narrower, purpose was to give insurance companies a narrow antitrust exemption to enable them to engage in cooperative rate making. Id. The three-prong Pireno test articulated by this Court to define the phrase "business of insurance" in the McCarran-Ferguson Act evolved in response to insurance company attempts to circumvent antitrust laws by invoking the McCarran-Ferguson Act. Each of the three cases decided by this Court, from which the Pireno test derived, involved the secondary antitrust purpose of the McCarran-Ferguson Act and not the primary regulatory

purpose of that Act. See Union Labor Life Ins. Co. v. Pireno, 458 U.S. 119 (1982); Group Life & Health Ins. Co. v. Royal Drug Co., 440 U.S. 205 (1979); Securities & Exchange Commission v. National Securities, Inc., 393 U.S. 453 (1969). The present case involves interpretation of the primary, regulatory function of the McCarran-Ferguson Act. In this context, the test for determining whether the "business of insurance" is involved should give equal recognition to the regulatory purpose of the Act, which includes protection of the ability of the states to fulfill their paramount responsibility in insurance regulation - insurer solvency and payment of policyholder claims even in the event of insurer insolvency.

ARGUMENT

A. THE LEGISLATIVE HISTORY OF THE MCCARRAN-FERGUSON ACT OF 1945 AND LEARNED TREATISES DEMONSTRATE THAT STATE INSURANCE CODE PROVISIONS ESTABLISHING THE PRIORITY FOR PAYMENT OF CLAIMS AGAINST INSOLVENT INSURERS MANIFESTLY REGULATE THE "BUSINESS OF INSURANCE"

1. In General:

The major premise of the Solicitor General's brief is that through the Supremacy Clause of the United States Constitution,[2] the federal super priority statute[3] preempts Ohio insurance code insolvency provisions governing payment of policyholder and other claims.[4] The

---

2/ U.S. Const. art. VI, cl. 2 provides in part: "[T]he Laws of the United States...shall be the supreme law of the land."

3/ 31 U.S.C. §3713.

4/ The Ohio Insurers Supervision, Rehabilitation and Liquidation Act, Ohio Rev. Code Ann. §§ 3903.02(D) and 3903.42 (Anderson 1989).

Government asserts further that the Ohio statute is not shielded from this preemption by the McCarran-Ferguson Act because it does not specifically relate to the business of insurance.

The correctness of the Government's argument hinges on the definition of the "business of insurance" as set out in the McCarran-Ferguson Act, which states in relevant part:

> (a) The business of insurance,...shall be subject to the laws of the several States...
>
> (b) No Act of Congress shall be contrued to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance... unless such Act specifically relates to the business of insurance.

15 U.S.C. §1012 (emphasis added). The Solicitor General argues that the state insurance code provisions which assign priorities for payment of claims against

insolvents do not involve the "business of insurance." Contrary to the Government's belief,[5] this key phrase is not defined in the McCarran-Ferguson Act, and its meaning cannot be determined simply from reading the Act.[6] Accordingly, this Court has instructed that resort to both the legislative history of the Act and authoritative treatises on insurance are necessary to discern the meaning of this all important phrase. Group Life & Health Ins. Co. v. Royal Drug Co., 440 U.S. 205, 210-212 (1979).

5/ Brief for Petitioners at 7.

6/ See Fabe v. United States Dep't. of Treasury, 939 F.2d 341 at 344 (6th Cir. 1991) ("although the Act exempts from federal preemption only those state regulations which concern the 'business of insurance,' neither the Act nor its legislative history is particularly enlightening as to the meaning of the term.") (citing Securities & Exchange Commission v. National Securities, Inc., 393 U.S. 453, 459 (1969)).

2. The Legislative History:

The Solicitor General's analysis of the legislative history of the McCarran-Ferguson Act[7] does not describe fully the concerns of Congress when enacting the legislation. The legislative history of the McCarran-Ferguson Act demonstrates that Congress recognized that an insurance policy is an empty promise unless the company issuing it is capable of paying claims when made, and that state regulations aimed at this concern did involve the business of insurance. This Court noted such congressional concern in Royal Drug by observing that the Congress which enacted the McCarran-Ferguson Act was aware that the very purpose of insurance regulation was concern over insurer insolvency. Royal Drug, 440 U.S. at 221.

7/ Brief for Petitioners at 19-20.

Perhaps the clearest expression of this concern by Congress came from Senator Ferguson, the co-author of the McCarran-Ferguson Act, who addressed it squarely:

> The sale of insurance is not the same as the sale of an article in a store. When one buys an article in a store, he brings it home with him. In the case of insurance, he buys a <u>promise</u> to pay upon the happening of a certain event, and that event may be the burning of his home. If the company is not sound and <u>solvent</u> at the time the house burns, or <u>at the time the claim is made</u>, <u>there is not insurance at all</u>. That is what we have tried to avoid.

91 Cong. Rec. 1481 (1945) (emphasis added). At 90 Cong. Rec. 6564-65 (1944), Representative Vorys remarked:

> The companies have the sacred trust of investing the policyholders' money wisely so as to maintain themselves in position to meet the terms of their contracts, long after the contract is made. This is the feature of the business of insurance which sets it apart from all others. It is always based upon a contract whereby the company must maintain itself in a position to carry out its contracts long after they are written and long after the

> policyholders have paid their money to the company. One of the problems in the regulation of insurance is to make sure that the company charges enough to remain solvent. One of the dangers affecting insurance is the company that offers too much for too little and then finds itself in a position where it cannot carry out its contracts.

90 Cong. Rec. 6564-65 (1944).

Representative Hancock also noted the importance of insurer solvency to the "business of insurance":

> The nature of insurance calls for uniformity and a regulation of competition rather than unrestricted competition. Unrestricted competition does not concern itself with the solvency of a seller, for the ordinary commercial transaction is closed with the sale. On the other hand, the writing of an insurance policy contemplates that the insurer will be able to perform in the future, for the promise of indemnity of the insurer must be performed in the future. Therefore, the solvency of the insurer is of prime importance in insurance. It follows that adequacy of rates is even of more importance than low rates.

90 Cong. Rec. 6526 (1944).

The concerns expressed at the time the McCarran-Ferguson Act was enacted continue to exist in Congress today. Congress has recently examined the findings of the Subcommittee on Oversight and Investigations regarding causes of insurance company failures, focusing on insolvencies of property and casualty insurance companies. _See_ Staff of House Comm. on Energy and Commerce, 101st. Cong., 2d Sess., _Failed Promises: Insurance Company Insolvencies_ (Comm. Print 1990). That report stated relevantly:

> An insurer's ability to pay--_its solvency_--must be subjected to proper regulation on a continuing basis, from the time premium payments are accepted until the time all anticipated insured events have occurred. The policyholder must rely on the competency of the regulatory system, as well as the skill and integrity of the insurer, for protection from insolvency.

_Id._ at 1 (emphasis added). The report stated further that "_the Federal government_

does not presently regulate the activities and solvency of insurance companies. Congress delegated this function exclusively to the states through the McCarran-Ferguson Act of 1945...." _Id._ at 56 (emphasis added). These comments underscore the fact that state regulation of insurance company insolvencies to protect policyholders is part of the "business of insurance."

C. _Learned Treatises:_

This Court also has recognized that learned treatises provide valuable instruction regarding the scope of the phrase "business of insurance." _Royal Drug_, 440 U.S. at 211-12. According to 2 G. Richards, _The Law of Insurance_ §207, _Selection and Control of the Risk_ (5th ed. 1952), "it has been stated that 'the fundamental _raison d'etre_ of insurance is to pay losses.'" In other words, for insurance to exist the loss payment facet cannot be divorced from the risk assumption facet.

The assumption and transfer of risk factor is addressed in 1 G. Couch, Cyclopedia of Insurance Law §1:3 (2d ed. 1984). According to Couch, "a primary requisite essential to a contract of insurance is the assumption of a risk of loss and the undertaking to indemnify the insureds against such a loss." Therefore, the two parts, assumption of a risk of loss and undertaking to actually indemnify against the loss, are inseparable. Without both of these factors, there is no insurance.

Another scholar points out that insurance is:

> (1) a social device in that people and organizations help themselves and each other by exchanging relatively small certain premiums for economic security against potentially large losses, (2) involves a large group of people or organizations who are exposed to risks, (3) allows each person or organization who becomes an insured to transfer risk to the whole group, as evidenced by an insurance contract, (4) involves

> the systematic accumulation of funds through the statistical prediction of losses and calculations of premiums, and (5) pays for losses in accordance with the terms of an insurance contract.

Athearn and Pritchett, Risk and Insurance 44 (5th ed. 1984) (emphasis added).

Finally:

> [I]nsurers promise to pay if and when the event insured against occurs, but payments from buyers are required in advance. Industrial and mercantile companies sell goods usually delivered to the buyers before payment. If an insurer becomes insolvent and is unable to honor its promises, its customers lose not only the purchase price but also resources relied on to replace damaged property, meet liability claims, provide income during periods of disablity, pay medical expenses, or support surviving dependents. Furthermore, persons winning judgments against insureds may be unable to collect damages, creating a social injustice.

Mehr, Cammack and Rose, Principles of Insurance 715 (8th ed. 1985); see also Greene and Trieschmann, Risk and Insurance 524 (6th ed. 1984) (role of State insurance

departments in regulating insurer solvency); Vaughan, Fundamentals of Risk and Insurance 144 (4th ed. 1986) (goals of insurance regulation by State are solvency and equity to insureds); Denenberg, Eilers, Melone and Zelten, Risk and Insurance 618-19 (2d ed. 1974) ("there are some who believe that solvency should be the only objective of insurance regulation"); Rejda, Principles of Insurance 565 (1982) (in which the author points out that state regulation of insurance company solvency includes requirements to maintain solvency, as well as procedures to fulfill the fundamental goals of insurance once a company becomes insolvent).

As the legislative history of the McCarran-Ferguson Act and learned commentary demonstrate, insurance does not exist unless payment is received by the policyholder for a valid claim. Senator Ferguson's simple and straightforward observation, quoted

above, is at the heart of what every person who buys insurance knows - you have bought no protection at all unless at the time a loss occurs a claim payment is made. However intellectually satisfying it may be to argue that the transfer of risk actually occurs at the time the policy is issued and not when a claim is paid, such analysis does not go far in comforting an insured who has suffered a covered loss, but cannot be paid because the insurance company is insolvent. Where the state endeavors to fulfill the promise of insurance by taking over the failed insurer and giving priority to the payment of policyholder claims, it tortures common sense to say this is unrelated to the "business of insurance." To openly make this argument in the hope of augmenting the Treasury of the United States at the expense of individual citizen insureds, when the Government's claim originates from its status as a policyholder

or insured, and not as a sovereign, is as ca.lous as it is unpersuasive.

B. THE MEANING OF THE PHRASE "BUSINESS OF INSURANCE" MAY ALSO BE DETERMINED BY REVIEWING FEDERAL ABSTENTION CASES

A significant number of federal courts have addressed the question of what constitutes the "business of insurance" in the context of resolving motions to abstain from exercising federal jurisdiction in cases involving state insurance liquidation receiverships. As the Sixth Circuit Court of Appeals recognized, the reasoning employed in these cases also is helpful in understanding what the phrase "business of insurance" means. Fabe, 939 F.2d at 16. In these abstention cases the federal courts employed the Burford doctrine,"[8] and abstained from exercising federal

8/ Burford v. Sun Oil Co., 319 U.S. 315 (1943).

jurisdiction because they were mindful that state efforts to regulate the winding up of insolvent insurance companies and the payment of claims by policyholders was the business of insurance for purposes of the McCarran-Ferguson Act. Although these cases did not decide the precise issue presented here, they demonstrate why both logic and fairness compel the conclusion that state insurance regulations designed to promote payment of policyholder claims are central to the business of insurance.[9]

In Barnhardt Marine Ins., Inc. v. New England International Surety of America, Inc., 961 F.2d 529 (5th Cir. 1992), the

9/ The government itself refers to cases decided in the context of resolving issues not directly involving the interpretation of the McCarran-Ferguson Act, but which shed light on what the "busines of insurance" is. Brief for Petitioners at 17, citing Pilot Life Ins. Co. v. Dedeaux, 481 U.S. 41 (1987) (interpreting ERISA) and Metropolitan Life Ins. Co. v. Massachusetts, 471 U.S. 724 (1985) (also interpreting ERISA).

Fifth Circuit recently declared Burford abstention appropriate in a federal action brought against an insurance company which was the subject of ongoing state liquidation proceedings when the federal case was brought. Barnhardt, 961 F.2d 529, 531. The Fifth Circuit Court of Appeals recognized two circumstances in which the application of the Burford doctrine is appropriate: when difficult state law questions of policy are present which are of substantial and far-reaching public concern and when the exercise of federal jurisdiction over the question involved would disrupt state efforts to set a uniform policy on a matter of substantial public concern. Id. The court decided that "Louisiana's insurance laws provide a comprehensive framework for the liquidation of insolvent insurance companies and the resolution of claims against them." Id.; see also Martin Ins. Agency, Inc. v. Prudential

Reinsurance Co., 910 F.2d 249 (5th Cir. 1990). Finally, the court declared that by allowing Barnhardt to recover the same assets, litigation of Barnhardt's claims in federal court would usurp Louisiana's control over the liquidation proceeding by allowing Barnhardt to preempt others in the distribution of NEISA's assets. Barnhardt, 961 F.2d at 932.

In Hartford Casualty Ins. Co. v. Borg-Warner Corp., 913 F.2d 419 (7th Cir. 1990), the Seventh Circuit affirmed the dismissal of an action against the parent company of an insolvent insurer based on abstention.[10] The Borg-Warner court determined that under the regulatory power given to the states by the McCarran-Ferguson

---

10/ The district court also had dismissed the action on ripeness and standing issues, however the Seventh Circuit found the case to be "best understood in terms of abstention." Borg-Warner, 913 F.2d at 424.

Act over insurance, states have enacted legislation to regulate the rehabilitation and liquidation of insolvent insurers. Borg-Warner, 913 F.2d at 426. Therefore, the court decided the states had a "paramount interest" over anyone else in the regulation of a uniform rehabilitation process.

> With the McCarran-Ferguson Act stating congressional policy that insurance regulation is up to the states, it is difficult to understand how Hartford can maintain that a federal court should entertain a lawsuit where it will have to decide the amount and existence of liability that an insolvent Illinois insurer owes to Hartford.

Borg-Warner, 913 F.2d at 426.

The Seventh Circuit Court of Appeals in Borg-Warner relied heavily on the Tenth Circuit's recent look into the issue of federal court abstention in the context of a state statutory scheme of regulating insolvent insurance companies. Grimes v. Crown Life Ins. Co., 857 F.2d 699 (10th Cir.

1988), cert. denied, 489 U.S. 1096 (1989). The Tenth Circuit Court of Appeals referred to "traditional federal deference provided to state receivership proceedings,"[11] which when considered in conjunction with "complex and comprehensive procedures adopted for the liquidation of insolvent insurers pursuant to the provisions of the McCarran Ferguson Act," allowed the court to decline to exercise jurisdiction over a suit between the state liquidator of an insolvent insurer and a reinsurer. Grimes, 857 F.2d at 703-704.

The Second Circuit has repeatedly affirmed the application of Burford abstention by federal district courts who

---

11/ For the cases cited by the Tenth Circuit, see Penn General Casualty Co. v. Pennsylvania ex rel. Schnader, 294 U.S. 189 (1935); Commonwealth of Pennsylvania v. Williams, 294 U.S. 176 (1935); Duggins v. Hunt, 323 F.2d 746 (10th Cir. 1963); Inland Empire Ins. Co. v. Freed, 239 F.2d 289 (10th Cir. 1956).

have declined to exercise jurisdiction over actions involving insolvent insurance companies. See Corcoran v. Ardra Ins. Co., Ltd., 842 F.2d 31 (2nd Cir. 1988); Law Enforcement Ins. Co. v. Corcoran, 807 F.2d 38 (2nd Cir. 1986), cert. denied, 481 U.S. 1017 (1987); Levy v. Lewis, 635 F.2d 960 (2nd Cir. 1980). In each of these three cases, the Second Circuit Court of Appeals acknowledged approvingly New York's "complex administrative and judicial system for regulating and liquidating domestic insurance companies." Levy v. Lewis, 635 F.2d at 963, quoted in Corcoran v. Ardra Ins. Co., 842 F.2d at 37 and in Law Enforcement Ins. Co. v. Corcoran, 807 F.2d at 44. Deferring to state procedures with respect to insurance liquidations pursuant to the McCarran-Ferguson Act was found to be mandated by that Act and, in fact, proper in light of its "express federal policy of noninterference in insurance matters." Levy

v. Lewis, 635 F.2d at 963, quoted in Law Enforcement Ins. Co. v. Corcoran, 807 F.2d at 44; see also Lac D'Amiante du Quebec, Ltee. v. American Home Assurance Co., 864 F.2d 1033 (3rd Cir. 1988) (applying Burford abstention in an action by an asbestos seller against an insurer placed in liquidation).

The holdings reached in these cases illustrate the logic of the conclusion that state regulations governing the payment of policyholder claims through insolvency proceedings does come within the purview of the "business of insurance" as Congress intended that phrase to be interpreted in the McCarran-Ferguson Act. While, admittedly, they did not involve super priority claims by the government filed with insolvent insurer receiverships, they did involve questions much more closely related

to those presented in this case than those which were involved in the trilogy of cases which produced the three part Pireno test.[12]

C. THE UTILITY OF THE PIRENO TEST AS THE SOLE TEST TO DETERMINE WHAT IS THE BUSINESS OF INSURANCE IS QUESTIONABLE IN CASES INVOLVING THE PRIMARY, REGULATORY FUNCTION OF THE MCCARRAN-FERGUSON ACT

When determining what is meant by the phrase "business of insurance" in the McCarran-Ferguson Act, the fact that the Act was intended to further two distinct goals should not be overlooked. The primary purpose of the McCarran-Ferguson Act was to ensure continued state regulation of the business of insurance. Royal Drug, 440 U.S. 205, 217-218. Congress' goal in passing the statute was "broadly to give support to the existing and future state systems for regulating and taxing the business of

12/ Pireno, 458 U.S. 119; Royal Drug, 440 U.S. 205; National Securities, 393 U.S. 453.

insurance." Prudential Ins. Co. v. Benjamin, 328 U.S. 408, 429 (1946) (emphasis added). Therefore, in cases involving the primary purpose of the Act, it should be appropriate to broadly interpret the meaning of the phrase "business of insurance" in order to fulfill its primary purpose. In contrast, there was a secondary and more narrow purpose Congress had in mind when the Act was passed, and that was to provide a narrow antitrust exemption to insurance companies to enable them to engage in cooperative rate making, which otherwise would have violated antitrust laws. Royal Drug, 440 U.S. at 218 n. 18.

The narrow antitrust exemption of the McCarran-Ferguson Act, constitutes only a secondary purpose of the Act. Royal Drug, 440 U.S. at 218 n. 18. Significantly, exemptions from the antitrust laws are to be narrowly construed. Id. at 231. This, too, makes perfect sense. When enacting the

McCarran-Ferguson Act; Congress wanted to preserve and encourage the ability of states to regulate insurance without federal interference, but did not want to concomitantly allow insurance companies to take advantage of the antitrust exemption provisions of the Act to engage in anti-competitive activity. Congressional concern that insurance companies, given an inch, might try to take a mile, was not misplaced. All three of the cases decided by this Court in the development of the Pireno test arose from efforts by insurance companies to use the McCarran-Ferguson Act as a shield to protect against charges of antitrust activity.[13] The three part Pireno

13/ Pireno, 458 U.S. 119 (alleged conspiracy to eliminate price competition among chiropractors); Royal Drug, 440 U.S. 205 (agreements to fix the retail prices of drugs and pharmaceuticals); National Securities, 393 U.S. 453 (merger of two insurance companies).

test properly evolved as a bar to such efforts by insurance companies to circumvent antitrust laws by invoking the protection of the McCarran-Ferguson Act, and this Court recognized the fact that this was the context in which the test was being employed. "[T]he only issue before us is whether petitioners' peer review practices are exempt from antitrust scrutiny as part of the 'business of insurance.'" Pireno, 458 U.S. 119, 126 (emphasis added). Further, this Court has often repeated that exemptions from antitrust laws are to be narrowly construed, while at the same time recognizing that this secondary purpose of the McCarran-Ferguson Act was quite distinct from its primary purpose of preserving state regulation of the business of insurance. Royal Drug, 440 U.S. at 218 n. 18.

While it may go too far to suggest that the Pireno test for the meaning of the phrase "business of insurance" in the

McCarran-Ferguson Act should be limited only to the context of cases interpreting the antitrust exemption of that Act,[14] it also should not be adopted as the exclusive test for defining that phrase, particularly with regard to cases such as this, which involve the primary regulatory purpose of the Act. Instead, this Court should employ a test which gives equal recognition to the unique characteristics of the promise embodied by an insurance policy, the efforts by state insurance regulators to fulfill that promise by adopting measures to effect the priority payment of policyholder claims in insurance

14/ Indeed, this Court has, on several occasions, looked to the Pireno test to determine what the business of insurance encompassed in contexts other than the interpretation of the McCarran-Ferguson Act. Pilot Life Ins. Co. v. Dedeaux, 481 U.S. 41 (1987) (interpretation of the Employee Retirement Income Security Act of 1974 (ERISA)); Metropolitan Life Ins. Co. v. Massachuetts, 471 U.S. 724 (1985) (interpreting ERISA).

company receiverships, and the intent of Congress that states should be able to engage in this type of regulation without federal interference. In cases such as this, where the super priority claim of the United States to assets of an insolvent insurance company arises from its status as the beneficiary or insured under an insurance policy or surety bond, and not as a sovereign,[15] then the state insurance activity in question does involve the "business of insurance," and the McCarran-Ferguson Act's protections should fully apply.

15/ An example of when a claim by the government would be in its sovereign capacity would be a tax claim filed against an insolvent insurer.

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be affirmed.

Paul W. Grimm*
Mary Alice McNamara
Gina M. Harasti
Niles, Barton & Wilmer
1400 Legg Mason Tower
111 S. Calvert Street
Baltimore, Maryland 21202
(410) 783-6300
*Counsel of Record

No. 91-1513

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

UNITED STATES DEPARTMENT OF THE TREASURY AND MITCHELL A. LEVINE, ASSISTANT COMMISSIONER,

Petitioners,

v.

GEORGE FABE, SUPERINTENDENT OF INSURANCE, STATE OF OHIO,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

BRIEF FOR THE NATIONAL CONFERENCE OF INSURANCE LEGISLATORS, AS AMICUS CURIAE SUPPORTING RESPONDENT

STEPHEN W. SCHWAB
Counsel of Record
DAVID E. MENDELSOHN
GAIL M. GOERING
RUDNICK & WOLFE
203 North LaSalle Street
Suite 1800
Chicago, Illinois 60601
(312) 368-4000

Counsel for Amicus Curiae

Midwest Law Printing Co., Chicago 60611, (312) 321-0220

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Statutes:

Miscellaneous:

No. 91-1513

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

UNITED STATES DEPARTMENT OF THE TREASURY AND MITCHELL A. LEVINE, ASSISTANT COMMISSIONER,

Petitioners,

v.

GEORGE FABE, SUPERINTENDENT OF INSURANCE, STATE OF OHIO,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

---

BRIEF FOR THE NATIONAL CONFERENCE OF INSURANCE LEGISLATORS, AS AMICUS CURIAE SUPPORTING RESPONDENT

INTEREST OF THE AMICUS CURIAE

Founded in 1969, the National Conference of Insurance Legislators ("NCOIL") is a voluntary organization of legislators from 35 states who are involved in the development of public policy and the enactment of insurance-related legislation. One of NCOIL's purposes is stated succinctly in its Articles of Organization: to "reaffirm the traditional primacy of the states in the regulation of insurance."

With asset holdings of over $1.5 trillion, insurance companies are quasi-public financial institutions whose regulation is essential to the stability of domestic and foreign financial markets, as well as to the protection of policyholders. Edward B. Rappaport, Congressional Research Service, *CRS Report to Congress: Insurance Company Solvency* 1 (1989). With knowledge of these facts, Congress for nearly 200 years has entrusted the states with almost exclusive authority over insurance regulation. The states have responded systematically to that charge by enacting comprehensive legislation regulating insurance companies from licensure through dissolution. Each state has a department devoted exclusively to insurance regulation, including receivership administration.[1] The insurance departments of NCOIL's member states presently oversee the conservation, rehabilitation and liquidation of at least 329 insurance companies.[2] National Association of Insurance Commissioners, *Contact Person Report (Status of Multistate Insurance Company Departmental Supervisions, Conservatorships, Rehabilitations and Liquidations)* a-i (June 1992) (hereinafter "*Contact Person Report*").

[1] Some states (*e.g.*, Texas) administer insurance receiverships through independent contractors, while statutory or court-appointed receivers in other states administer them through private or quasi-public entities (*e.g.*, Illinois).

[2] There generally are three stages of insurance receivership: conservation (or supervision), rehabilitation and liquidation. In conservation, the receiver takes possession of an insurer's assets, business and affairs to conserve them for the benefit of creditors. *See, e.g.*, Illinois Insurance Code § 188.1, Ill. Rev. Stat. ch. 73, ¶ 800.1 (1991). Rehabilitation vests title to the company's assets in the receiver. *Id.* § 191, Ill. Rev. Stat. ch. 73, ¶ 803. Its purpose is the "preservation, whenever possible, of the business of an insurance company threatened with insolvency." *People ex rel. Schacht v. Main Ins. Co.*, 448 N.E.2d 950, 952 (Ill. App. Ct. 1983). Liquidation precludes the transaction of further business by the company and results in a final distribution of its assets. *See generally* Illinois Insurance Code §§ 187-221, Ill. Rev. Stat. ch. 73, ¶¶ 799-833.

Pursuant to Rule 37.2 of the Rules of this Court, NCOIL respectfully submits this brief as *amicus curiae* in support of Respondent. NCOIL has reviewed and adopts Respondent's arguments. In addition, its members have a substantial interest in the outcome of this case and can provide a unique perspective on the important issues presented. NCOIL believes that this brief will assist the Court in analyzing and resolving those issues. The parties have consented to the filing of this brief, and their written consents have been filed with the Clerk of the Court.

SUMMARY OF ARGUMENT

Congress' endorsement of state insurance regulation has come into conflict with a federal statute which has nothing to do with insurance. Enacted in 1797, the federal insolvency statute, 31 U.S.C. § 3713 (the "Superpriority Statute"), grants the federal government first priority for payment of its claims from an insolvent debtor's assets, and imposes personal liability upon any debtor or trustee who pays another creditor first. Congress enacted this statute to secure an adequate revenue for the federal government. *United States v. Key*, 397 U.S. 322, 324 (1970). The new Republic represented a savior from the tyranny of English rule, and the Superpriority Statute was passed to ensure its prosperity. Since then, however, public opinion "as to the peculiar rights and preferences due to the sovereign" has changed, *Davis v. Pringle*, 268 U.S. 315, 318 (1925), and the Superpriority Statute no longer serves the purpose for which it was enacted. As Congress observed 15 years ago, "the time has [passed] when the sovereign . . .

is entitled to the first fruits of every insolvent estate." H.R. Rep. No. 595, 95th Cong., 1st Sess., pt. 1, at 194 (1977).

Consistent with this change, Congress has modified the Superpriority Statute to preclude its application in most receiverships. The Court already has held the Statute inapplicable in national bank receiverships, and Congress since has loosed the Statute's grip on thrifts. Likewise, Congress has eliminated the Statute's application to insurance receiverships. Three federal statutes contain terms that are inconsistent with the Superpriority Statute, and their language and legislative history reveal a purpose incongruous with its application to insurance receiverships. Both the language and legislative history of § 22 of the Bankruptcy Act of 1898, 11 U.S.C. § 22 (repealed 1978) (the "1898 Act"), and §§ 109(b)(2) and (d) of the Bankruptcy Reform Act of 1978, 11 U.S.C. §§ 109(b)(2), (d) (the "1978 Code"), reveal that Congress intended to leave insurance receivership administration to the states. Likewise, the language and history of the McCarran-Ferguson Act, 15 U.S.C. §§ 1011-15 ("McCarran"), confirm that Congress meant for the states to regulate insurance companies from cradle to grave. Finally, the 1978 amendment to the Superpriority Statute, 31 U.S.C. § 3713(a)(2), reiterated Congress' intent to relegate the United States to a lower priority in the vast majority of receivership proceedings. When enacting each of these statutes, Congress knew the states had adopted legislation regulating all facets of insurance receiverships, including asset distribution. It thus would be absurd for Congress to authorize the states to determine in the public interest how the assets of an insolvent insurer should be distributed, only to undermine that determination by forcing payment of federal claims first.

NCOIL offers this brief because the United States' claim to a superpriority in insurance receiverships ignores Congress' expressed intent. The Sixth Circuit's decision upholding the State of Ohio's priority scheme sustains the purposes underlying the federal bankruptcy statutes and McCarran, and respects the states' authority to regulate insurance. In the face of Congress' consistent deference to state authority over all insurance matters, the United States' argument should be rejected and the Sixth Circuit's decision affirmed.

ARGUMENT

THE SUPERPRIORITY STATUTE DOES NOT APPLY TO INSURANCE RECEIVERSHIPS

The parties agree that the issue in this case is whether the Superpriority Statute applies to insurance receiverships, and the parameters for its resolution are well-established. The Statute will apply unless it has been repealed or modified either expressly or implicitly by a subsequent federal enactment. *Key*, 397 U.S. at 324 (1970). *Key* teaches that the Superpriority Statute is implicitly modified by legislation adopting a priority scheme if that legislation is logically inconsistent with the Statute, or if the legislation's language or legislative history reveals a purpose incongruous with the Statute's application. *Id.* at 326. Stated another way, "[e]xceptions to clearly delineated statutes will be implied only where essential to prevent 'absurd results' . . . ." *United States v. Rutherford*, 442 U.S. 544, 552 (1979) (citing *Helvering v. Hammel*, 311 U.S. 504, 510-11 (1941)).

This Court never has decided whether the 1898 Act, the 1978 Code and McCarran together have modified the Superpriority Statute. Other courts considering the superprior-

ity issue acknowledged that Congress has precluded insurance companies from being bankruptcy debtors, but otherwise focused their attention solely on McCarran.[3] In so doing, they overlooked the historical development of state insurance receivership law and thus the significance of Congress' consistent deference to that law. NCOIL believes it is vitally important that the Court not decide this case in an historical vacuum.

A. FEDERAL BANKRUPTCY LEGISLATION AND McCARRAN EVINCE CONGRESS' INTENT THAT THE SUPERPRIORITY STATUTE NOT APPLY TO INSURANCE RECEIVERSHIPS

1. The Bankruptcy Act of 1898

Until 1898, Congress was unable to enact a bankruptcy scheme that was more than a solution to temporary problems. Spencer L. Kimball, *History and Development of the Law of State Insurer Insolvency Proceedings: An Overview, in Law and Practice of Insurance Company Insolvency* 5 (David M. Spector, ed. 1986). The first three attempts to enact a permanent law in 1800, 1841 and 1867, all failed to produce the desired result—the 1800 and 1841 acts survived little more than a year, while the 1867 act

[3] *Fabe v. United States Dep't of the Treasury*, 939 F.2d 341, 347 (6th Cir. 1991), *cert. granted*, 112 S. Ct. 1934 (1992); *Idaho ex rel. Soward v. United States*, 858 F.2d 445, 450 (9th Cir. 1988), *cert. denied*, 490 U.S. 1065 (1989); *Gordon v. United States Dep't of the Treasury*, 846 F.2d 272 (4th Cir. 1987), *cert. denied*, 488 U.S. 954 (1988); *Lyons v. United States*, No. 4-91-10209, 1992 U.S. Dist. LEXIS 11714, at *5 (S.D. Iowa July 2, 1992); *Garcia v. Island Program Designer, Inc.* 791 F. Supp. 338, 341 (D. P.R. 1992); *see In re Union Indem. Ins. Co.*, 551 N.Y.S.2d 446 (Sup. Ct. 1990), *aff'd sub nom. Curiale v. United States*, 566 N.Y.S.2d 853 (App. Div. 1991), *petition for cert. filed*, 60 U.S.L.W. 3617 (U.S. Feb. 24, 1992) (No. 91-1347).

was repealed in 1874. *Id.* at 5-6. As a necessary consequence of Congress' inability to adopt an enduring bankruptcy scheme, the states enacted their own insurance receivership laws. *See, e.g., Carr v. Hamilton*, 129 U.S. 252 (1889) (state liquidation proceedings against life insurer instituted in 1879, after repeal of the 1867 Act). The first provisions for the receivership of insurance companies were adopted in 1828. *See* Rev. Stat. of N.Y., ch. XVIII, tit. II (1835). By 1898, California, Illinois and Texas[4] all had enacted legislation governing insurance company receiverships. *See* 1868 Cal. Stat. ch. CCC, §§ 7, 8; Ill. Rev. Stat. ch. 73, ¶¶ 84-92 (1874); Tex. Civ. Stat. Ann. tit. LVIII, ch. 2, art. 3050 (Batt's 1895) (incorporating insurance insolvency provisions from "An Act to create the Department of Insurance, Statistics and History," passed Aug. 21, 1876).

Meanwhile, Congress in 1864 enacted a receivership system for national banks. National Bank Act, ch. 106, 13 Stat. 99 (codified as amended at 12 U.S.C. § 21 *et seq.*). That act included a priority scheme which did not accord the federal government a superpriority. *See* 12 U.S.C. § 194. Section 194 established a ratable distribution plan which granted a first priority to the United States for the limited purpose of redeeming the debtor bank's circulating notes. In 1883, the Court held that this provision precluded application of the Superpriority Statute to bank receiverships:

[4] California, Illinois, New York and Texas historically have accounted for a comparatively large number of insurance receiverships. *See Contact Person Report, supra.* At present, these four states administer 142 of the 329 insurance receiverships under NCOIL members' control. *Id.*

> These provisions could not be carried out if the United States were entitled to priority in the payment of a demand not arising from advances to redeem the circulating notes. . . .
>
> These provisions must be deemed, therefore, to withdraw national banks, which have failed, from the class of insolvent persons out of whose estates demands of the United States are to be paid in preference to the claims of other creditors. The law of 1797 giving priority to the demands of the United States against insolvents, cannot be applied to demands against those institutions.

Cook County Nat'l Bank v. United States, 107 U.S. 445, 450-51 (1883).[5]

These federal and state receivership measures reflected the significant positions that banks and insurance companies always have occupied in the national economy. Like banks, insurance companies play a unique role in ensuring the public welfare and maintaining the public trust. Depositors put their money in banks to secure their financial positions, while policyholders buy insurance to guard against unexpected loss. Both depositors and policyholders expect their money to be available when they need it. House Subcommittee on Oversight and Investigations of

[5] The United States may argue, however, that the Superpriority Statute still applies to federal claims against *state* banks and savings associations, perhaps relying on *Bramwell v. United States Fidelity & Guar. Co.*, 269 U.S. 483 (1926), and *United States v. Oklahoma*, 261 U.S. 253 (1923). These early cases are inapposite, however, given the subsequent enactment of the Federal Deposit Insurance Act, 12 U.S.C. §§ 1811-33e (the "FDIA"), the Financial Improvement, Recovery, Reform and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183 (amending 12 U.S.C. § 1821), and the FDIC Improvement Act of 1991, Pub. L. No. 102-242, 105 Stat. 2236 (amending 12 U.S.C. § 1821(c)). *See also* 12 C.F.R. § 360.2 (1992) (expressing federal policy that state law govern distribution priorities in bank receiverships).

the Committee on Energy and Commerce, *Failed Promises: Insurance Company Insolvencies* 1 (Comm. Print 1990). Accordingly, Congress has recognized that, while insolvency is a consequence of free market competition, it is unacceptable in "quasi-public" industries like banking and insurance.[6] *Id.*; *see also* Larry D. Carlson, *The Insurance Exemption from the Antitrust Laws*, 57 Tex. L. Rev. 1127, 1138-39 (1979). This congressional concern has produced pervasive regulation of those industries and justifies exception of state insurance priority schemes from the Superpriority Statute.

In 1898, Congress enacted a bankruptcy statute which remained in place (as amended) until 1978. Bankruptcy Act of 1898, ch. 541, 30 Stat. 544 (codified as amended at 11 U.S.C. § 1 *et seq.*), *repealed by* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549. Marking a significant departure from the past, the 1898 Act contained a priority scheme which displaced the Superpriority Statute in bankruptcy liquidations. *United States v. Emory*, 314 U.S. 423, 428 (1941). As in the 1867 Act, *see, e.g.*, *Sawyer v. Hoag*, 84 U.S. 610 (1873) (bankruptcy petition filed against insurer in 1872) insurance companies and banks could be bankruptcy debtors. Thus, in 1898, Congress determined that the Statute would not apply in insurance liquidations.

In 1910, however, the Act was amended to preclude insurance companies and banks from being bankruptcy

[6] Contrary to the United States' assertions, Petitioner's Brief at 8, 18, policyholders do not "bear the risk" of their insurer's insolvency. *See generally* United States General Accounting Office, *Insurer Failures: Life/Health Insurer Insolvencies and Limitations of State Guaranty Funds* (1992) (describing how guaranty funds assume a failed insurer's policy obligations); United States General Accounting Office, *Insurer Failures: Property/Casualty Insurer Insolvencies and State Guaranty Funds* (1987) (same).

debtors. Three characteristics common to those institutions warranted the exclusion (both then and now): "(1) they are extensively regulated by well-organized departments of the states and of the United States; (2) they are subject to express statutory procedures for liquidation; and (3) the nature of their business is public or quasi-public and involves interests other than those of creditors." *First Am. Bank & Trust Co. v. George*, 540 F.2d 343, 349 (8th Cir. 1976), *cert. denied and appeal dismissed*, 429 U.S. 1011. By excepting banks and insurance companies from the 1898 Act, Congress acknowledged the adequacy of established state receivership machinery. *Woolsey v. Security Trust Co.*, 74 F.2d 334, 337 (5th Cir. 1934). As the Second Circuit observed: "The most natural inference is that Congress meant to leave to local winding up statutes the liquidation of such companies; that, since the state commonly kept supervision over them during their lives, it was reasonable that they should take charge on their demise." *In re Union Guar. & Mortgage Co.*, 75 F.2d 984 (2d Cir. 1935), *cert. denied*, 296 U.S. 594.

By endorsing state administration of insurance receiverships, Congress perforce agreed that the states should continue ordering priorities of asset distribution. Priority schemes always had been an integral part of receivership administration, particularly liquidations; the State of Illinois, for example, enacted its first priority distribution statute for insurance receiverships in 1874. *See* Act of Feb. 17, 1874, Ill. Rev. Stat. ch. 73, ¶ 89 (repealed 1925). Surely Congress did not entrust the liquidation of insolvent insurance companies to such a well-developed body of state law without the concomitant power to determine the priority of asset distribution. By amending the 1898 Act to except insurance companies, Congress acknowledged that the states had enacted sufficient legislation governing insurance receivership administration, and that

they should continue to do so without federal interruption. Congress confirmed this intent in 1945.

2. The McCarran-Ferguson Act of 1945

Congress' 1945 enactment of the McCarran-Ferguson Act, ch. 20, 59 Stat. 33 (1945) (codified at 15 U.S.C. §§ 1011-15), confirmed the states' authority to regulate all aspects of the business of insurance. By that time, most states had adopted insurance receivership schemes that were modeled on the New York statute, N.Y. Ins. Law ch. 30, §§ 400-28 (Consol. 1932), and the Uniform Insurers Liquidation Act, 13 U.L.A. 321 *et seq.* (1939) (the "UILA"). *Cf.* 1935 Cal. Stat. ch. 291, § 1010 *et seq.*; Ill. Rev. Stat. ch. 73, ¶¶ 799-833 (1935); Tex. Rev. Civ. Stat. Ann. tit. 78, art. 5068c (1939); *see also* 1936 National Ass'n of Ins. Comm'rs Proc. 30-32 ("An act relating to the rehabilitation, reorganization or liquidation of insurers doing business in more than one state"). The New York statute contained a priority scheme consistent with settled common law principles: administration expenses were paid first, N.Y. Ins. Law ch. 30, § 419, followed by wage claims, *id.*, and then all other claims according to priorities the receivership court directed. *Id.* § 426. Equity interest claims were paid last. It was to predecessors of those receivership schemes that Congress deferred in 1910 when it excepted insurance companies from federal bankruptcy proceedings, and those schemes were part of the "*status quo*" that the United States concedes McCarran was intended to preserve. *See* Petitioner's Brief at 23. Congress' sweeping endorsement of state regulation in McCarran thus confirmed its intent that the states continue administering insurance receiverships.[7] Indeed, the

[7] This Court's decision in *United States v. Knott*, 298 U.S. 544 (1936), does not compel a different result. *Knott* was decided *before* McCarran and § 109 of the 1978 Code were enacted, and before

(Footnote continued on following page)

Court quickly upheld the statute against a challenge that Congress had no power to consent to such legislation.[8] *Prudential Ins. Co. v. Benjamin*, 328 U.S. 408, 438 (1946).

Consistent with its endorsement of state receivership legislation, Congress determined that the Superpriority Statute would not apply to insurance receiverships. This intent is expressed in the language of McCarran. Section 2 provides that no act of Congress may invalidate, impair or supersede a state regulatory law unless that act specifically relates to the business of insurance. 15 U.S.C. § 1012(b). The antitrust, labor and merchant marine laws identified in §§ 3 and 4, *Id.* §§ 1013, 1014, are the only exceptions to this rule. Conspicuously absent is any reference to the Superpriority Statute. Senator O'Mahoney, one of the Senate conferees and a floor manager of the legislation (91 Cong. Rec. 1208 (1945)), explained why: "[A] good faith attempt was made to specify *every single law* which had an application, or might have an application, to insurance." 91 Cong. Rec. 483 (1945) (emphasis added). Thus, McCarran's "coordinated exercise of federal and state authority," *Prudential*, 328 U.S. at 438, preserved

[7] *continued*

the Superpriority Statute was amended. *See infra* part 3. The decision addressed whether securities deposited in Florida by an insolvent New Jersey insurance company constituted a perfected lien and thus should be used first to pay the claims of Florida creditors before the federal government's claim. This Court simply was not asked whether the Superpriority Statute applied in insurance receiverships.

[8] It follows that McCarran's approval of state receivership statutes does not violate the constitutional mandate in Article I, Section 8, Clause 4 that bankruptcy laws be uniform throughout the United States; only *federal* bankruptcy laws are so limited. *See Prudential*, 328 U.S. at 438 (rejecting argument that McCarran's sanction of state tax laws violated uniformity requirements of Article I, Section 8, Clause 1, and holding that the limitation applies only when federal taxing power "is exerted without reference to any state action").

state administration of insurance receiverships by suspending the application of federal laws (like the Superpriority Statute) that do not relate specifically to the business of insurance.

Following its adoption, the states considered McCarran a congressional mandate to enact legislation governing all aspects of the business of insurance. Accordingly, their chief insurance regulators joined forces through the National Association of Insurance Commissioners ("NAIC") and the Conference on Uniform State Laws to enact model or uniform legislation "to cover regulation of insurance growing out of the Supreme Court decision [in *United States v. South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944)] and [McCarran]." 1945 National Ass'n of Ins. Comm'rs Proc. 263. In particular, they focused their attention on receivership law: "The uniform liquidation act has been adopted by many states, and Departments whose states do not have a good liquidation act, might well review the act . . . ." *Id.* at 264. Before McCarran was enacted, seven states had adopted the UILA; another 26 states ultimately joined their ranks. 13 U.L.A. at 321.

In 1967, the states began re-ordering the priority of receivership claims to protect policyholders. That year, the State of Wisconsin enacted a new insurance receivership statute which created a separate creditor class for policyholders above general creditors, and relegated federal claims to a lower priority. Wis. Stat. Ann. § 645.68 (West 1980). The Wisconsin legislature regarded preferred treatment of policyholder claims as essential to protect vulnerable consumers who purchased insurance for the sole purpose of avoiding loss:

> [The policyholder] class contains the claims central to the social role of insurance. The typical policy is not an ordinary mercantile contract, but one of great

public importance. In the usual case, if a policyholder loses a premium, he is not seriously harmed, but if a loss goes unpaid, or even unpaid in substantial measure, great harm is likely to be done.

Wis. Stat. Ann. § 645.68(3) cmt. at 510.

The commentary to the Wisconsin statute reveals the legislature acknowledged a potential conflict with the Superpriority Statute, but determined that § 22 of the 1898 Act and McCarran had resolved any conflict in favor of state legislation:

> Congress exempted insurance companies from the operation of the [1898] Act in recognition of the fact that they are subject to a complete system of state regulation, which extends to the rules governing insolvency. . . . [I]t is clear that insurance regulation in general, and this chapter in particular, *including the section on priorities*, is part and parcel of the regulatory structure, and has a real impact on the ongoing insurance operation. It follows, therefore, that the [Superpriority Statute] cannot "invalidate, impair, or supersede" the priority system of this section.

Wis. Stat. Ann. § 645.68(5) cmt. at 513 (emphasis added). Since then, courts repeatedly have recognized the states' right to establish priority schemes and administer insurance receiverships.[9] *See, e.g., Baldwin-United Corp. v. Garner*, 678 S.W.2d 754, 758 (Ark. 1984), *cert. denied*, 471 U.S. 1111 (1985). ("If any meaning is to be given to the congressional exclusion of insurance companies from the [1898 Act] and the mandate of the McCarran-Ferguson Act, it must be that the determination of rights among

[9] The United States' suggestion (Petitioner's Brief at 24 n. 11) that all state courts have held or assumed the Superpriority Statute applies in insurance receiverships post-McCarran, therefore, is in error.

an insurance company's creditors must be left to state proceedings"); *see also Grode v. Mutual Fire, Marine and Inland Ins. Co.*, 572 A.2d 798, 808 (Pa. Commw. 1990), *aff'd sub nom. Foster v. Mutual Fire, Marine and Inland Ins. Co.*, No. J-108-1990 (Pa. Aug. 21, 1992) (stating without deciding that "McCarran-Ferguson would appear to preclude the application of the [Superpriority Statute]"); *Lyons* and *Garcia*, *supra*, n. 3.

3. The Bankruptcy Reform Act of 1978

After extensive examination of the federal bankruptcy system, Congress in 1978 improved the 1898 Act with a "modernized" bankruptcy code. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (codified as amended at 11 U.S.C. § 101 *et seq.*). Re-codifying § 22 of the 1898 Act as §§ 109(b)(2) and (d) of the 1978 Code, Congress reiterated its intent to consign the conservation/supervision, rehabilitation and liquidation of insurance companies to established state law: "Banking institutions and insurance companies engaged in business in this country are excluded from liquidation under the bankruptcy laws because they are bodies for which alternate provision is made for their liquidation under various State or Federal regulatory laws." S. Rep. No. 989, 95th Cong., 2d Sess. 31 (1978). Here is the unmistakable expression of congressional intent that state law govern insurance receiverships.[10] By entrusting receivership administration

[10] Congress certainly did not have the Superpriority Statute in mind when it referred to "Federal" regulatory laws. As demonstrated above, both § 22 of 1898 Act and case law construing that provision, *see, e.g., Woolsey*, 74 F.2d at 337, indicate that the "alternate provision" to which Congress referred was the well-developed body of state insurance receivership law and the federal laws regulating banks, *e.g.*, the National Bank Act and the FDIA.

to the states, Congress expressed its intent that state law govern priorities of distribution. Today, in all but 13 states, the federal government's claims are relegated to a position equal to or lower than policyholders, depending on the nature of the claim; in only four states (Arizona, California, Florida and Virginia) are federal claims accorded absolute priority. *See* Appendix; *see also* Wis. Stat. Ann. § 645.68 cmt. at 508 ("claims that are socially more important need to be paid ahead of those that are less important").

Congress did not limit the expression of its intent to the reforms made in the 1978 Code. Recognizing that the United States no longer needed the protection of the Superpriority Statute in the vast majority of receivership proceedings, Congress expressly amended the statute in 1978 to exempt all bankruptcy proceedings from its reach. *See* Act of Nov. 6, 1978, Pub. L. No. 95-598, § 322(a), 92 Stat. 2678 (codified at 31 U.S.C. § 3713(a)(2)) ("This subsection does not apply to a case under title 11."). The rationale for the amendment was straightforward:

> Equality of distribution is the rule in bankruptcy, and supported by long years of strong bankruptcy policy. . . . There have been steady calls for the elimination or reduction of the non-tax priority of the United States, especially in bankruptcy cases, *where the priority is exercised at the expense of other creditors of the bankrupt.*

H.R. Rep. No. 595, 95th Cong., 1st Sess. 285 (1977) (emphasis added).

The United States' argument that the Superpriority Statute trumps state insurance receivership laws by virtue of the Supremacy Clause, U.S. Const. art. VI, cl. 2, erroneously assumes that the Statute has "survived to this day essentially unchanged." Petitioner's Brief at 6, 10 (quoting

United States v. Moore, 423 U.S. 77, 80 (1975)). In fact, Congress in 1978 eviscerated the Superpriority Statute when it excepted the vast majority of receivership proceedings from the Statute's reach.[11] *See* 31 U.S.C. § 3713(a)(2). Thus, having relinquished its superpriority claim, the United States cannot seriously contend that the Statute is "fundamental" (Petitioner's Brief at 11) to the national government's success.

The fact that the Superpriority Statute was not amended to exclude bank and insurance receiverships is of no moment. By the 1978 amendment, Congress simply put its federal bankruptcy house in order. Distributions in federal liquidation proceedings had fallen outside the statute's reach for 80 years, *see Emory*, 314 U.S. at 428; the amendment merely extended that protection to federal reorganization proceedings, *see Key*, 397 U.S. at 326 (Superpriority Statute imposed upon bankruptcy reorganizations under 1898 Act). There was no need to address the well-recognized banking and insurance exceptions already embodied in the 1978 Code.[12]

[11] The significance of the amendment is easily demonstrated. During 1980, 331,098 bankruptcy cases were filed, and 292,929 remained pending at the end of the year. Administrative Office of the United States Courts, *Federal Judicial Workload Statistics* (Dec. 31, 1990) 11. During 1990, those numbers had grown to 782,960 and 1,033,230, respectively. *Id.* Among the debtors included in those statistics are Texaco, Pan Am, Johns-Manville and Continental Airlines. In contrast, from 1975 through 1990, only 176 life/health insurers were declared insolvent and placed into receivership. *Life/Health Insurer Failures*, *supra*, at 3. Between 1969 and 1990, 372 property/casualty insurers suffered the same fate. A.M. Best Co., Inc., *Best's Insolvency Study: Property/Casualty Insurers 1969-90* 2 (June 1991).

[12] Congress had provided for distributions in bank receiverships under the National Bank Act, 12 U.S.C. § 194, and this Court had recognized the modification of the Statute wrought by that Act.

(Footnote continued on following page)

B. CONGRESS HAS MODIFIED THE SUPERPRIORITY STATUTE

As demonstrated above, § 22 of the 1898 Act, §§ 109(b)(2) and (d) of the 1978 Code, and McCarran are logically inconsistent with the terms of the Superpriority Statute. Moreover, their language and legislative history reveal a congressional purpose incongruous with the Statute. As a result, the federal bankruptcy laws and McCarran have implicitly modified the Superpriority Statute and excepted insurance receiverships from its application.

The logical inconsistency between the federal bankruptcy laws and McCarran, and the Superpriority Statute cannot be reconciled. The Statute is a deceptively simple act, suggesting that it applies to all non-bankruptcy proceedings. However, it squarely conflicts with McCarran, which provides that only federal laws specifically relating to insurance may trump state laws, and identifies only limited exceptions to this rule. The Superpriority Statute does not mention insurance and is not among those exceptions. A more patent inconsistency between statutes is difficult to imagine. Moreover, by §§ 22 of the 1898 Act and 109(b)(2) and (d) of the 1978 Code, Congress manifested its intent that state law govern insurance receivership administration. When those sections were enacted, states already had adopted receivership laws containing priority distribution schemes

[12] *continued*

Cook County Nat'l Bank, *supra*. In 1950, Congress expressly adopted state priority schemes for the liquidation of insured state banks, *see* 12 U.S.C. § 1821(e), and in 1989 and 1991 extended the reach of this provision to include insured state savings associations, *see* 12 U.S.C. §§ 1813, 1821. Similarly, Congress enacted McCarran for the express purpose of precluding application of the Superpriority Statute and all other federal acts not related to insurance. 15 U.S.C. § 1012(b).

which did not accord a superpriority to federal claims. Congress thus placed its imprimatur upon state receivership laws, including priority schemes that are inconsistent with the Superpriority Statute.

Applying the Statute to insurance receiverships also is incongruous with longstanding federal policies favoring state supervision and liquidation of insolvent insurers, protection of policyholders, and maintenance of public confidence in the insurance industry. Since 1910, federal bankruptcy laws have made insurance receivership regulation the sole province of the states. In response to this congressional mandate, the states have shouldered the responsibility for regulating all aspects of those receiverships. In a lawful exercise of their police power, most states have enacted priority schemes which prefer policyholder claims over those of general creditors and the federal government, for good reason. Unlike most individual policyholders, the United States is a sophisticated creditor and insurance consumer, able to protect itself adequately against unexpected loss. Consequently, requiring the government to underwrite policyholder loss serves a significant social interest:

> [T]hat social interest is attested to by the staggering amount spent by the federal government, and even by state and local governments, on various insurance-like schemes to deal with a great variety of problems, as often as not after the fact. Medicare and Medicaid should suffice to illustrate the point . . . .

Kimball, *supra*, at 33. State schemes elevating policyholder claims over those of general creditors and the United States protect the innocent consumer from the ruinous consequences that may follow when he or she suffers a loss and limited funds are available for compen-

sation. The resulting benefits to policyholders dwarf any residual gains derived from an absolute federal priority.

Imposing the Superpriority Statute upon insurance receiverships contravenes Congress' intent to secure for policyholders the full measure of state protection. The states cannot protect policyholders if the United States is allowed to diminish or even exhaust estate assets by invoking the Statute. Surely, after consenting to state administration of receiverships, Congress could not have intended to trump state priority schemes,[13] diminish policyholder protection, and paralyze receivers with the threat of personal liability for paying anyone else first. While equal treatment of unsecured creditors is the rule in federal bankruptcies, all states have determined that this principle cannot be applied in insurance receiverships, where protection of policyholders is the paramount concern. Effecting Congress' intent to protect the most vulnerable creditors of public or quasi-public entities also requires that the Superpriority Statute not apply to receiverships specifically designed to provide that protection.

[13] This incongruity is all the more acute where the payment of federal claims pursuant to the Superpriority Statute depletes estate assets before policyholders are paid. As such, the Statute not only trumps state priority schemes, but may render them meaningless.

CONCLUSION

Congress has declared repeatedly that experienced and knowledgeable state legislatures and officials are best placed to balance competing rights of creditors in insurance receiverships, and has entrusted the states with that responsibility. Applying the Superpriority Statute to insurance receiverships creates an unacceptable paradox: the Statute does not apply where creditors do not need extra protection, but does apply to deny protection to those who need it most of all. In other words, those who purchased insurance specifically to avoid risk of loss are less protected than creditors of bankrupts who knowingly assumed that risk in commercial ventures. Acknowledging the Statute's modification avoids this paradox and is most consonant with Congress' consistently expressed intent that the administration of insurance receiverships is the *states'* responsibility. Superimposing a federal superpriority upon established, sophisticated state receivership systems can only throw their administration into unnecessary turmoil.

Therefore, the Sixth Circuit's decision should be affirmed.

Respectfully submitted,

STEPHEN W. SCHWAB
Counsel of Record
DAVID E. MENDELSOHN
GAIL M. GOERING
RUDNICK & WOLFE
203 North LaSalle Street
Suite 1800
Chicago, Illinois 60601
(312) 368-4000
Counsel for Amicus Curiae

APPENDIX

State	Priority Scheme	Private Policyholder Claims[1]	Federal Government Policyholder Claims	Other Federal Government Claims
Alabama	Alabama Code §27-32-37	preferred over general creditors	NSP[2]	recorded tax liens preferred over policyholders
Alaska	Alaska Stat. §21.78.260	(3)	(3)	(5), (8)
Arizona	Ariz. Rev. Stat. Ann. §20-629	preferred over general creditors	absolute priority	absolute priority
Arkansas	Ark. Code Ann. §23-68-126	(3)	NSP	(5), (8)
California	Cal. Ins. Code §1033	(5)	(4)	(4)
Colorado	Colo. Rev. Stat. §10-3-507	(c)	NSP	(b) for taxes and debts secured by perfected liens[3]
Connecticut	Conn. Gen. Stat. §38a-944	(3)	(3)	(6), (8)
Delaware	Del. Code. Ann. tit. 18, §5918	preferred over general creditors	NSP	taxes preferred over policyholder claims

State	Priority Scheme	Private Policyholder Claims	Federal Government Policyholder Claims	Other Federal Government Claims
D.C.	D.C. Code Ann. §35-1508	(4)	NSP	(3) for taxes secured by perfected liens; (5) for other claims
Florida	Fla. Stat. Ann. §631.271	(4)	(2)	(2)
Georgia	Ga. Code Ann. §33-37-41	(3)	(3)	(5), (8)
Hawaii	Hawaii Rev. Stat. §431: 15-332	(4)	NSP	(6), (8)
Idaho	Idaho Code §41-3342	(3)	NSP	(5), (8)
Illinois	Ill. Rev. Stat. ch. 73, ¶817(1)	(c)	(c)	(b) for taxes and debts secured by perfected liens; (d) for other claims
Indiana	Ind. Code §27-9-3-40	(3)	NSP	(5), (8)
Iowa	Iowa Code Ann. §507C.42	(3)	(3)	(5), (8)

State	Priority Scheme	Private Policyholder Claims	Federal Government Policyholder Claims	Other Federal Government Claims
Kansas	1991 Kan. Sess. Laws ch. 125, §37	(3)	(3)	(5), (8)
Kentucky	Ky. Rev. Stat. Ann. §304.33-430	(3)	(3)	(4), (7)
Louisiana	La. Rev. Stat. Ann. §22:746	(3)	NSP	NSP
Maine	Me. Rev. Stat. Ann. tit. 24-A, §4379	(3)	(3)	(5), (8)
Maryland	Md. Code Ann., Ins. §§158, 158A	preferred over general creditors	NSP	taxes preferred over policyholder claims
Massachusetts	Mass. Gen. L. ch. 175, §180F	(4)	NSP	(3) for taxes and debts secured by perfected liens
Michigan	Mich. Comp. Laws §500.8142	(3)	NSP	(5), (8)
Minnesota	Minn. Stat. Ann. §60B.44	(4)	(4)	(3) for taxes required to be withheld from wages; (6), (9)

State	Priority Scheme	Private Policyholder Claims	Federal Government Policyholder Claims	Other Federal Government Claims
Mississippi	Miss. Code Ann. §83-24-83	(3)	(3)	(5), (8)
Missouri	Mo. Ann. Stat. §375.1218	(2)	(2)	(5), (8)
Montana	Mont. Code Ann. §33-2-1371	(3)	NSP	(5), (8)
Nebraska	Neb. Rev. Stat. §44-4842	(3)	NSP	(5), (8)
Nevada	Nev. Rev. Stat. Ann. §696B.420	(3)	(3)	(5), (8)
New Hampshire	N.H. Rev. Stat. Ann. §402-C: 44	III	III	IV, VII
New Jersey	N.J. Stat. Ann. §17:30C-26c	(4)	NSP	(3) for taxes and debts secured by perfected liens
New Mexico	N.M. Stat. Ann. §59A-41-44	C	C	E, K[4]
New York	N.Y. Ins. Law §§7426, 7435[5]	(4)	NSP	(5), (8)

State	Priority Scheme	Private Policyholder Claims	Federal Government Policyholder Claims	Other Federal Government Claims
North Carolina	N.C. Gen. Stat. §58-30-220	(3), (5)	NSP	NSP
North Dakota	N.D. Cent. Code §26.1-06.1-41	(3)	(3)	(5), (8)
Ohio	Ohio Rev. Code Ann. §3903.42	3	NSP	(5), (8)
Oklahoma	Okla. Stat. Ann. tit. 36, §1927	3	NSP	NSP
Oregon	Or. Rev. Stat. §734.360	(4)	NSP	(3) for taxes
Pennsylvania	Pa. Stat. Ann. tit. 40, §221.44	(c)	NSP	(e), (g)
Puerto Rico	P.R. Laws Ann. tit. 26, §4012	preferred over general creditors	NSP	NSP
Rhode Island	R.I. Gen. Laws §27-14-22	(d)	NSP	(c) for taxes
South Carolina	S.C. Code Ann. §38-27-610	(3)	(3)	(5), (9)

State	Priority Scheme	Private Policyholder Claims	Federal Government Policyholder Claims	Other Federal Government Claims
South Dakota	S.D. Codified Laws Ann. §58-29B-124	3	NSP	5, 8
Tennessee	Tenn. Code Ann. §59-9-330	3	3	5, 8
Texas	Tex. Ins. Code Ann. §8	2	2	3
Utah	Utah Code Ann. §31A-27-335	(3)	(3)	(5), (6)
Vermont	Vermont Stat. Ann. tit. 8, §7081	(3)	(3)	(5), (8)
Virgin Islands	V.I. Code Ann. tit. 22, §1277	3	NSP	5, 8
Virginia	Va. Code Ann. §§38.2-1509, 1514	(iv)	(iii)	(iii) for taxes and other debts entitled to priority
Washington	Wash. Rev. Code Ann. §48.31.280	(d)	NSP	(c) for taxes

State	Priority Scheme	Private Policyholder Claims	Federal Government Policyholder Claims	Other Federal Government Claims
West Virginia	W. Va. Code §33-10-19a	III	III	V, VIII
Wisconsin	Wis. Stat. Ann. §645.68	(3)	(3)	(5), (8)
Wyoming	Wyo. Stat. §26-28-125	(iii)	(iii)	(iv)

1 Under the Wisconsin statute, claims were organized by priority. Most states rank claims as follows: (1) administrative expenses; (2) wages; (3) policyholders; (4) general creditors; (5) government claims; (6)-(8) subordinated claims and equity. The numbers and letters used in this table reflect the statutory class assigned to the claims identified in each column.

2 "NSP" appears where the relevant statute does not contain a specific provison for the claims in question.

3 In each instance where a reference to perfected liens appears in this table, the liens must have been perfected prior to commencement of the receivership proceedings.

4 Paragraph E contains a reference to Paragraph K; however, there is no such Paragraph.

5 Section 7435 relates only to distributions of assets of life insurers in receivership.

(15)

No. 91-1513

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

UNITED STATES DEPARTMENT OF THE TREASURY AND MITCHELL A. LEVINE, ASSISTANT COMMISSIONER,

Petitioners,

v.

GEORGE FABE, SUPERINTENDENT OF INSURANCE, STATE OF OHIO,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

BRIEF FOR STEPHEN F. SELCKE, DIRECTOR OF INSURANCE, STATE OF ILLINOIS, AS STATUTORY AND COURT-APPOINTED RECEIVER, *AMICUS CURIAE* SUPPORTING RESPONDENT

PETER G. GALLANIS
Counsel of Record
Chief General Counsel to the Director, as Receiver
Office of the Special Deputy Receiver
222 Merchandise Mart Plaza
Suite 1450
Chicago, Illinois 60654
(312) 836-9500

Counsel for Amicus Curiae

Midwest Law Printing Co., Chicago 60611, (312) 321-0220

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Statutes:

Miscellaneous:

No. 91-1513

In The

Supreme Court of the United States

October Term, 1992

UNITED STATES DEPARTMENT OF THE TREASURY AND MITCHELL A. LEVINE, ASSISTANT COMMISSIONER,

Petitioners,

v.

GEORGE FABE, SUPERINTENDENT OF INSURANCE, STATE OF OHIO,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

---

BRIEF FOR STEPHEN F. SELCKE, DIRECTOR OF INSURANCE, STATE OF ILLINOIS, AS STATUTORY AND COURT-APPOINTED RECEIVER, *AMICUS CURIAE* SUPPORTING RESPONDENT

INTEREST OF THE *AMICUS CURIAE*

Stephen F. Selcke, the Director of Insurance of the State of Illinois, is obliged by statute to serve as receiver of troubled insurance companies operating within the State (in such capacity the "Receiver"). Ill. Rev. Stat. ch. 73,

¶¶ 799-833 (1991).[1] Illinois is the state of domicile of 448 insurance companies, the largest number in the country behind Arizona, Texas, and New York.[2] Currently, the Director serves as the receiver of a total of 42 companies; of that number, the Director is the receiver of 38 domestic companies, and the "ancillary" receiver of 4 foreign companies.

The interest of the *amicus curiae* in this case appears from a brief review of his obligations under Illinois law, and the conflict that would follow, were Petitioners to prevail in their interpretation of the federal superpriority statute, 31 U.S.C. §3713 (hereinafter the "FPS").

The Director is assisted in the performance of his duties by a special deputy receiver, and by various legal, financial, and insurance professionals who work under the direction of the Director, in his capacity as Receiver. Ill. Rev. Stat. ch 73, ¶ 814. The Receiver is formally appointed by Illinois courts upon the filing of a complaint by the State Attorney General, demonstrating the existence of one or more statutorily enumerated grounds for receivership. *Id.* ¶¶ 800, 800.1. Receivership is a last resort after less drastic means have failed to resolve the affected company's problems. *See, e.g., id.* ¶¶ 646, 789.1. In that sense, receivership is at the end of a continuum of State insurance regulation aimed at protecting the interests of policy owners and beneficiaries.

[1] When acting as statutory receiver, the Director is not a state officer. *People ex rel. Knight v. O'Brien*, 240 N.E.2d 686 (Ill. 1968). When acting as regulator, however, the Director is the state officer primarily responsible for executing the Illinois laws and regulations affecting the business of insurance.

[2] National Association of Insurance Commissioners, *Insurance Department Resources Report* 33 (1990).

As regulator, the Director and his staff monitor the activities of insurers operating in the State. Assuring company solvency—that is, the financial ability to satisfy policy obligations—is a principal objective of that regulatory scrutiny. The Director insures solvency by, *inter alia*, imposing minimum capitalization requirements, *id.* ¶ 655; requiring foreign insurers to secure their obligations by depositing specified securities, *id.* ¶ 723(f)(3); mandating that letters of credit or other collateral be posted to assure the performance of "non-admitted" reinsurers, *id.* ¶ 785.1; and requiring the prudent investment of insurers' funds, *id.* ¶¶ 736-737.24a.

The Director's solvency-related regulatory activities are inextricably linked with his role as Receiver. Monitoring insurers' compliance with solvency standards not only safeguards the ability of operating companies to fulfill their policy obligations; violation of those requirements is a basis for seeking the appointment of a receiver. *See, e.g., id.* ¶ 800. The threat of receivership is one of the most effective sanctions by which the Director can enforce compliance with regulatory requirements. Indeed, receivership is the ultimate regulatory sanction. *See, e.g., Chicago Life Ins. Co. v. Needles*, 113 U.S. 574 (1881). In the event that the Director is appointed Receiver, his statutory charge is dictated by the nature of the receivership.[3] As

[3] Illinois, for example, provides three stages of insurance receivership: conservation, rehabilitation, and liquidation. In conservation, the receiver takes possession of an insurer's assets, business and affairs to conserve them for the benefit of creditors. Ill. Rev. Stat. ch. 73, ¶ 800.1. Rehabilitation vests title to the company's assets in the receiver. *Id.* ¶ 804(2). Its purpose is the "preservation, whenever possible, of the business of an insurance company threatened with insolvency." *People ex rel. Schacht v. Main Ins. Co.*, 448 N.E. 2d 950, 952 (Ill. App. Ct. 1983). Liquidation precludes the transaction of further business by the company and results in a final distribution of its assets. Ill. Rev. Stat. ch. 73, ¶¶ 805, 806; *see generally id.* ¶¶ 799-833.

liquidator, the Receiver must marshal the company's assets and distribute them to policyholders and other claimants in the estate. Ill. Rev. Stat. ch. 73, ¶¶ 805, 817. Here, the Director's prior efforts (as regulator) to ensure company solvency generally maximize the assets available to meet the company's obligations.

Once a company is placed in receivership, it continues to function as an insurance company under the direction of the Receiver, in virtually all respects save the writing of new insurance policies.[4] In particular, the Receiver is responsible for satisfying the company's policy obligations, subject to asset availability. Like an operating company, the Receiver reviews claims, determining their validity and amount; he maintains reserves for ultimate distribution; and he distributes assets *pro rata* to those with valid claims.

A number of the estates for which the Receiver is responsible involve pending or potential claims arguably subject to FPS. For example, in the estate of Heritage Insurance Company of Illinois, in Liquidation, various federal agencies (including, *inter alia*, the Immigration and Naturalization Service and the Small Business Administration ("SBA")) have filed a total of 171 federal claims in respect of immigration bonds, SBA guaranty bonds, performance bonds, and bail bonds in the aggregate amount of approximately $332,000. Similarly, the Internal Revenue Service

[4] A company in conservation operates almost identically to a similar company outside receivership; in some rare instances, the company may even write new business. *See, e.g.* Ill. Rev. Stat. ch. 73, ¶ 646. Likewise, a company in rehabilitation may be virtually indistinguishable from a company outside receivership that is in "run-off"—a voluntary winding-up process in which the company ceases to write new policies and pays claims as they come due from reserves and other available funds.

("IRS") has asserted tax claims against other estates. For example, an IRS claim is now pending against Health Plan of Central Illinois, in Liquidation (a health maintenance organization) in the amount of over $2 million—greater than the total current assets of the estate. In addition, a number of property and casualty companies controlled by the Receiver involve pending or potential federal environmental claims. For example, Centaur Insurance Company, in Rehabilitation ("Centaur"), is defending such claims filed against policyholders by the Environmental Protection Agency, the National Oceanic and Atmospheric Administration, and other agencies. Although the estate's exposure in respect of those claims cannot be estimated at this time, the costs to date of legal defense alone are approximately $4 million. More significantly, the Receiver anticipates that Centaur (like many companies in receivership that wrote comprehensive general liability, products liability, and "umbrella" policies) may be subject to many other federal environmental claims before the estate is closed.

Pursuant to Rule 37.2 of the Rules of this Court, the Receiver respectfully submits this brief as *amicus curiae* in support of Respondent. The Receiver has reviewed and adopted Respondent's arguments; in addition, the Receiver has a substantial interest in the outcome of this case and can provide a unique perspective on the significant issues presented. The Receiver believes that this brief will assist the Court in analyzing and resolving those issues. The parties have consented to the filing of this brief, and their written consents have been filed with the Clerk of the Court.

SUMMARY OF ARGUMENT

Until 1944, the American legal system operated on the assumption that insurance was not "interstate commerce" and therefore beyond the power of Congress to legislate under the Interstate Commerce Clause of the Constitution. U.S. Const. art. I, § 8 cl. 3. That assumption followed from the Court's holding in the case of *Paul v. Virginia*, 75 U.S. (8 Wall) 168 (1868). The issue in *Paul* was whether Virginia restrictions on the powers of foreign insurers were invalid because Congress, and not the states, had the power under the United States Constitution to ". . . regulate commerce . . . among the several States." This Court resolved the issue by holding that the issuance of a policy of insurance was not a transaction of interstate commerce, but rather in the nature of a personal contract, entered into locally, and governed by the local law. *Id.* at 183. This decision, together with the narrow view of congressional power under the Commerce Clause that obtained until the New Deal (*see generally* Laurence Tribe, *American Constitutional Law* at 403-13 (2d ed., 1988)), encouraged the continuing development of comprehensive state regulation of insurance companies.

Paul remained the law until *United States v. South-Eastern Underwriters Association*, 322 U.S. 533 (1944). That case involved the applicability of the price-fixing and monopolization prohibitions of the Sherman Act to members of an insurance trade association. The Court rejected the contention based on *Paul* that Congress had no authority under the Interstate Commerce Clause to enact legislation affecting insurers. The Court concluded that the holding of *Paul* (that the Commerce Clause does not *prohibit* state insurance regulation) did not compel the conclusion that the Commerce Clause does not *authorize* federal legislation having an impact upon insurance. Under

the "stream of commerce" analysis that had recently been approved by this Court, *see, e.g., Wickard v. Fillburn*, 317 U.S. Ill (1937), the Court held that insurance is an enterprise conducting its activities across state lines, and therefore not beyond Congress' commerce power.

Even before the decision was rendered, concern grew in the states, the insurance industry, and Congress about the continued viability of state insurance regulation in the event that the Court ruled (as it did) in favor of the United States. Charles D. Weller, *The McCarran-Ferguson Act's Antitrust Exemption from Insurance: Language, History and Policy*, 1978 Duke L.J. 587, 592. Congress attempted to resolve those uncertainties by passing the McCarran-Ferguson Act, 15 U.S.C. §§1011-1015 ("McCarran").

The issue before this Court has divided the federal Circuit Courts of Appeal: whether the FPS applies to state insurance receiverships, notwithstanding Section 2(b) of McCarran.[5] The Receiver submits that the Petitioners' reading of FPS would virtually prevent him (and similarly situated receivers in other states) from performing the duties imposed upon him by state law. These duties are expected of state insurance receivers and were well known to Congress, both before and after *South-Eastern Underwriters* and the enactment of McCarran. Under the proper analysis, state insurance receivership priority statutes like the one at issue are clearly within the "business of insurance" for purposes of Section 2(b) of McCarran, and therefore are not affected by FPS.

---

[5] *See Idaho ex rel. Soward v. United States*, 858 F.2d 445 (9th Cir. 1988), *cert. denied*, 490 U.S. 1065 (1989) (FPS applies to state insurance receiverships); *Gordon v. United States Dept. of the Treasury*: 668 F. Supp. 483 (D. Md. 1987), 846 F.2d 272 (4th Cir. 1988), *cert. denied*, 488 U.S. 954 (1988) (same); *Fabe v. United States Dep't of the Treasury*, 939 F.2d 341 (6th Cir. 1991), *cert. granted*, 112 S.Ct. 1934 (1992).

ARGUMENT

THE POLICY OF STATE REGULATION OF INSURANCE PRECLUDES APPLICATION OF THE FEDERAL PRIORITY STATUTE TO INSURANCE RECEIVERSHIPS

A. PETITIONERS' INTERPRETATION OF THE "BUSINESS OF INSURANCE" WOULD WREAK HAVOC ON THE LONG-STANDING, FEDERALLY APPROVED SYSTEM OF STATE REGULATION AND RECEIVERSHIP OF INSURANCE COMPANIES.

In adopting McCarran, Congress reaffirmed its long-standing conclusion that states are responsible for the regulation and receivership of insurance companies. Petitioners' attempt to impose the restrictions of FPS on state receivers would seriously impair receivers in the performance of their statutory obligations, for the sake of an economic benefit to federal revenues far outweighed by the negative consequences to the intended beneficiaries of state insurance laws.

1. State Law Requires Receivers to Protect Policy Rights.

The primary obligation of a receiver in an insurance liquidation is the payment of claims to insureds and beneficiaries in accordance with the terms of their insurance policies. *See, e.g.*, Ill. Rev. Stat. ch. 73, ¶ 805.

Unlike federal bankruptcy proceedings, insurance receivership laws generally accord to policy claimants priority over other types of claimants in the estate.[6] Such

[6] *See* Davis Howard, *Uncle Sam Versus the Insurance Commissioners: A Multi-Level Approach to Defining the "Business of Insurance" Under the McCarran-Ferguson Act*, 25 Willamette L. Rev. 1, 10-14 (1989).

priority treatment is often justified on the grounds that policyholders frequently are unsophisticated consumers without negotiating leverage, who have little recourse but to accept contracts of adhesion from their insurers; whereas commercial creditors, who are usually accorded a lower distribution priority, have more information and bargaining power. Spencer Kimball, *History and Development of the Law of State Insurer Insolvency Proceedings: An Overview in Law and Practice of Insurance Company Insolvency* 33 (David M. Spector, ed. 1986).[7]

Consequently, typical state insolvency statutes require receivers to devote their primary and continuing attention to the rights of policyholders and the obligations of the subject company under the policies written by the

[7] Petitioners contend that the Ohio priority scheme (like that of Illinois, *cf. Ill. Rev. Stat.* ch. 73, ¶ 817) ranks two classes of claims (administrative expenses and modest wage claims of company employees) ahead of those of policyholders, thereby undermining the Court of Appeals' conclusion that the statute focused on policyholders protection. Brief for Petitioners at 21. Petitioners' contention is unavailing for two reasons.

First, the costs of marshaling assets in the estate must be provided if policyholders and lower priority claimants are to receive distributions, and these costs often include the need to retain the services of employees who worked for the insurer before receivership. This need prompted many courts to permit payment of administrative costs ahead of federal claims in cases where the FPS was held to apply. *See* Howard, *supra* note 6 at 2 n.4.

Second, and more generally, the fact that the statute indicates how residual assets are to be distributed *after* policyholder claims have been paid does not mean that the statute does not focus on the protection of policyholders. Clearly the residuum must go somewhere, and there is no more logical place in the statutes to indicate where the residuum goes than the clauses following those affording priority to policyholders. The simple point is that the policyholder is protected first.

company.[8] This Court has described such an emphasis—on the terms of the company's policy, its interpretation, and enforcement—as the "core" of the "business of insurance." *SEC v. National Securities, Inc.*, 393 U.S. 453, 460 (1969).

2. Application of FPS to Insurance Receiverships Would Drastically Interfere with Receivers' Duties Under State Laws.

Where applicable, FPS provides that claims of the United States must be paid before all other claims, 31 U.S.C. § 3713(a); and that a representative of the estate (*e.g.*, a receiver) is personally liable for the unpaid portion of any federal claim if he has paid other claims or expenses first. *Id.* § 3713(b). If these provisions applied to state receiverships, several drastic consequences would follow.

First, receivers could not satisfy their statutory obligations. In a liquidation, the goal is to marshal and distribute assets to holders of adjudicated claims as quickly as possible. Under Petitioners' analysis, the Receiver would be reluctant to liquidate estate assets to satisfy policy obligations or pay administrative expenses, since any resulting "shortfall" could be the basis for personal liability in the event of a subsequently asserted federal claim. In the case of a failed life or health insurer, this means that benefits for which policyholders and their beneficiaries paid, and on which they relied to avoid financial ruin, are deferred, if not eliminated altogether. Most states

[8] Much of the Receiver's attention is also devoted to matters that are inextricably related to the contractual relationship between the insurer and the insured; *e.g.*, maintaining and investing claim reserves; collection of related reinsurance; and the disposition of litigation involving the policy relationship.

guard against such possibilities by making life and health insurance "non-cancellable," and by empowering the liquidator to contract with another company to assume the failed insurer's outstanding policy obligations. *See, e.g.*, Ill. Rev. Stat. ch. 73, ¶¶ 805(4), 1065.80-8. Because insurance policies have a predetermined life span and need immediate attention to be kept alive, the liquidator needs unfettered use of estate assets to set reserves or transfer them to an assuming reinsurer. This Court's decision in *Chicago Life Ins. Co. v. Needles*, 113 U.S. 574 (1885), makes clear that such statutory protection is part of an insurance policy from the time it is issued. Petitioners, however, would sanction a liquidator for using estate assets to protect holders of non-cancellable policies, if the remaining assets were insufficient to cover federal non-insurance claims. This places the liquidator in a no-win situation.

Similar considerations apply to insurance rehabilitation proceedings. In most states the rehabilitator's charge is to remove the causes and conditions which made rehabilitation necessary. *See, e.g.*, National Association of Insurance Commissioners Insurers Rehabilitation and Liquidation Model Act ("NAIC Model Act") § 16(c); Ill. Rev. Stat. ch. 73, ¶ 804(1). Like a bankruptcy reorganization, insurance rehabilitation is a flexible procedure, designed for adaptation to the circumstances presented. However, like a liquidation proceeding, it may be premised on a finding of insolvency and always is begun with the entry of a court order of receivership. *See, e.g.*, NAIC Model Act § 17; Ill. Rev. Stat. ch. 73, ¶ 800 (1991). Technically, therefore, the FPS would be triggered in a rehabilitation. As a result, the rehabilitator cannot take immediate steps to save the company because any such steps may subject him to liability.

One of the Receiver's estates, American Mutual Reinsurance Company, in Rehabilitation ("AMRECO"), presents a case in point. AMRECO is a property/casualty reinsurer that was placed into rehabilitation in 1988. AMRECO pays claims four times a year; monies received from its own reinsurers fund the rehabilitation. The benefits of rehabilitation in this $340 million estate are undeniable: the solvency of AMRECO's own reinsureds is preserved, as is AMRECO's position as a tax-paying member of the community. *See generally In Re: American Mut. Reins. Co.*, No. 1-90-3384, slip op. (Ill. App. Ct. June 26, 1992); Debra J. Anderson, Stephen W. Schwab, Carolyn S. Reed, David E. Mendelsohn, *AMRECO: A Step Towards International Rehabilitations*, 7 J. Ins. Reg. 388 (1989). None of these steps could be taken as long as the threat of a potential, but as yet unasserted, federal claim remains. Petitioners blindly assume that liquidation is the only type of insurance receivership at stake in this case. Contrary to Petitioners' suggestion, rehabilitation does not entail a termination of the company's existence, but rather is dependent on its continued operation in "the business of insurance." *See* Brief for Petitioner at 8. Petitioners thus fail to appreciate that acceptance of their argument would do far greater damage to the insurance industry as a whole than would rejection of their position.

In addition, the Receiver would have no reliable way of knowing at any point whether a federal claim was likely to be asserted in the estate.[9] Consequently, the Receiver would not be able to determine whether funds were available to pursue activities designed to enhance or marshal assets. It should be obvious that uncertainty about the availability of funds to pay administrative expenses may cause a receiver to abandon at least some efforts to marshal into the estate assets that rightfully belong to the company.[10] This uncertainty ultimately redounds to Petitioners' detriment, since the estate then well may be without sufficient assets even to pay federal government claims. *A fortiorari*, if federal claims go unpaid, so do policyholders who need distributions of estate assets to stay in business; pay a decedent's pre-death obligations and funeral expenses; or cover the often catastrophic medical expenses of a disabling injury or disease. In the end, state insurance guaranty funds must absorb these costs, assessing their members for the loss before the members pass their costs on to policyholders in the form of increased premium charges, or to taxpayers, in the form of increased premium tax credits.[11]

[9] The United States has argued successfully that, under FPS, it is not required to file formal claims in accordance with estate claim-filing deadlines. *See, e.g., United States v. Summerlin*, 310 U.S. 414 (1940); *United States v. Oklahoma*, 261 U.S. 253 (1923).

Moreover, the threat of personal liability for "mistakes" in reserving for unknown and essentially unknowable federal claims likely would deter qualified people from serving as receivers or members of the receiver's staff. People buy insurance because they are risk averse. Similarly, few business people enter commercial ventures without some appreciation for the level and amount of risk they are undertaking. The size and frequency of certain federal claims (*e.g.*, environmental) present to a receiver an un-

[10] Examples of such activities include claims against corporate directors and officers for breach of fiduciary obligations; actions to recover assets fraudulently transferred or the subject of voidable preference laws; or arbitration to collect disputed reinsurance recoveries.

[11] *See generally* Howard, *supra* note 6, at 14-18.

justifiable risk—at least one that few competent receivers would undertake in many instances.

Finally, payment of federal claims before all others may deprive estates of the very assets that were made available principally to pay policyholders in the event a company became financially impaired. As noted above, Illinois (like most states) requires that insurers post deposits of specified assets to insure payment of their policy obligations. These "special deposits" are designated by statute for this purpose and are intended not to be used for any other.

The role of the states in dealing with the problems of impaired insurance companies has a long and generally successful history, and that history was well known to Congress when the McCarran-Ferguson Act became law. *See generally* Kimball, *supra*; *see also Prudential Ins. Co. v. Benjamin*, 328 U.S. 408 (1946). The earliest state receivership statute was enacted by New York in 1828. *See* Rev. Stat. of N.Y., ch. XVIII, tit. II (1835). The relative success of the states in this area compares favorably with the efforts of the federal government in certain fields,[12]

[12] *See, e.g.*, Justice Jackson's dissent in *South-Eastern Underwriters*, quoting a 1905 speech by Louis Brandeis:

> Doubtless the insurance departments of some States are subjects for just criticism. In many of the States the department is inefficient, in some doubtless corrupt. But is there anything in our experience of Federal supervision of other departments of business which should lead us to assume that it will be freer from grounds of criticism or on the whole more efficient than the best insurance department of any of the States? For it must be remembered that an efficient supervision by the department of any State will in effect protect all the policyholders of the company wherever they may reside. Let us remember rather the ineffectiveness for eighteen long years of the Interstate Commerce Commission to deal with railroad

(Footnote continued on following page)

at least in part because of the diligence and creativity with which state regulators and receivers have exercised the functions that were reserved to them under the McCarran.

Petitioners now proffer to this Court a construction of FPS that would prevent the states from performing effectively the comprehensive consumer protection role they have assumed at Congress' behest. In particular, Petitioners argue unconvincingly that some aspects of state policyholder protection can be ignored, while others must be respected. Brief for Petitioners at 15 n.5. To the contrary, the efforts of state regulators and receivers to ensure company solvency (*e.g.*, licensing standards *Ill. Rev. Stat.* ch. 73, ¶¶ 720-25; regulation of invested assets *id.* ¶¶ 736-737.24a;, monitoring financial performance *id.* ¶¶ 748, 751;, enforcement of statutory reserving requirements *id.* ¶¶ 853-65, and receivership proceedings, *id.* ¶¶ 799-833) comprise a seamless web of consumer protection from which one strand cannot be pulled without seriously damaging the entire pattern. Indeed, the Court held in 1885 that insurance receivership laws are a statutorily implied term of every insurance company's charter. *Needles*, 113 U.S. at 584. Moreover, the Court specifically held that "[e]very creditor must be presumed to understand "that an insurance company and its contracts are

[12] *continued*

> abuses, the futile investigation by Commissioner Garfield of the Beef Trust, and the unfinished investigation into the affairs of the Oil Trust in which he has since been engaged. Federal supervision would serve only to centralize still further the power of our Government and to increase still further the powers of the corporation.

322 U.S. at 593 n.17.

If Brandeis were addressing the same subject today, perhaps he would also refer to the performance of federal regulators in connection with the savings and loan and banking crises.

subject to state receivership laws," and to contract with reference to "those laws." *Id.* Thus the Court already has determined that insurance receivership laws are part of a state's regulation of the business of insurance, and that they comprise part of each policyholder's contract. For this reason, Petitioners' attempt to carve state receivership priorities out of the seamless web of insurance regulation ignores the interconnections between those provisions and other state insurance regulations.

Petitioners apparently wish this Court to endorse an interpretation of FPS that would substantially weaken the powers of the states to perform their insurance regulatory and receivership responsibilities. Through McCarran, Congress asked the states to protect policyholders. Petitioners should not now be permitted to wrest from state receivers the resources they need to do their job at the point when claimants most depend upon them—the point of insurer insolvency.

3. Applying FPS to Insurance Receiverships Would Result in an Inefficient Allocation of Scarce Public Resources.

Petitioners submit that a sweeping application of FPS is "fundamental to the success of the national government." Brief for Petitioners at 11. Undoubtedly this was a compelling proposition when FPS originally was adopted in 1797. At that time, the federal government had few sources of tax revenue, and the federal budget was so small that the inability to collect judgments might have materially affected the federal fisc. Today, contrary policy arguments are readily apparent.

As demonstrated above, the cost of Petitioners' proposal would be a substantial diminution in the effectiveness of state insurance regulation. It is tautological that estate

claimants would be deprived of policy benefits to at least the extent of federal claims afforded FPS priority. However, it would be simplistic to suppose that Petitioners' and Respondent's positions are only alternative outcomes in a "zero-sum" game; the result of Petitioners' proposal would be considerably worse because of the chilling effect on receivers described above.

The outcome urged by Petitioners would clearly result in a less efficient allocation of economic resources. Under Petitioners' scenario, a receiver would be obliged to minimize expenditures of estate funds, with the consequent diminution of asset-marshalling activities, and wait for the day when (if ever) the federal government might assert claims. Thus, the federal government might someday be paid on claims it could assert *ex post*, while in the meantime, cautious receivers facing potential personal liability would forego opportunities that otherwise might exist to maximize the collection of estate assets.

A far more efficient allocation of resources would follow from a decision that FPS does not apply to the activities of receivers in maximizing policyholder recoveries. In addition to eliminating the paralyzing effect of potential federal claims having superpriority status, Respondent's view would result in a clear, simple, predictable, *ex ante* system[13] for handling insolvencies—a system aimed primarily at protecting the integrity and reliability of the

[13] The social necessity of predictable legal rules known in advance to all affected parties is clearly recognized by legal and economic scholars. *See, e.g.*, Richard Wagner and James Gwartney, *Public Choice and Constitutional Order, reprinted in Public Choice and Constitutional Economics* (Gwartney and Wagner, eds., 1988).

insurance contract, as contemplated by this Court in *National Securities*, 393 U.S. at 460.[14]

B. UNDER THE SEMINAL *NATIONAL SECURITIES* TEST, REGULATION OF THE "BUSINESS OF INSURANCE" ENCOMPASSES STATE INSURANCE RECEIVERSHIP LAWS, WHOSE PRIORITY PROVISIONS PROTECT POLICY INTEGRITY AND ENFORCEABILITY.

An eminent student of this Court once wrote that "No answer is what the wrong question begets. . . ." Alexander Bickel, *The Least Dangerous Branch* 103 (1962). Petitioners devote considerable effort to demonstrating that the Ohio statute is not regulation of the "business of insurance" for McCarran purposes under the three-pronged test set forth in *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982). Brief for Petitioners at 15-22. In their zeal to force the *Pireno* test upon a case for which it was not intended, Petitioners are addressing the wrong question, and perforce providing no answer to the real issue.

1. The Primary Purpose of McCarran was to Preserve Broad State Powers to Regulate Insurance.

McCarran was a Congressional response to the decision of this Court in *South-Eastern Underwriters*. Both the legislative history of the Act and subsequent commentary

[14] In that respect, the existing state receivership statutes bear some similarities to state corporation laws. The receivership laws in effect amount to statutorily implied terms of the company's policy, affording certain rights to policy claimants, *Chicago Life Ins. Company v. Needles*, 113 U.S at 584, just as state corporation laws provide statutorily implied contract rights to creditors and shareholders of corporations. Frank Easterbrook and Daniel Fischel, *The Economic Structure of Corporate Law* 5-6, 14 (1991).

by the courts and legal scholars reveal that the Act had two primary purposes, both of which are readily apparent from its text.[15]

Because the FPS is an Act of Congress that does not specifically relate to the business of insurance, it cannot ". . . invalidate, impair, or supersede . . ." the Ohio statute. Thus, the obvious and ultimate issue is whether the Ohio statute and its priority provisions regulate the "business of insurance" under the primary thrust of McCarran.

Even before McCarran became effective, this Court held that states retained the power to enforce their insurance regulatory statutes after *South-Eastern Underwriters*. *Robertson v. California*, 328 U.S. 440 (1946). That the regulatory powers of the states were effectively preserved by McCarran was established peradventure in a better-known decision rendered the same day as *Robertson*, *Pru-*

[15] *See generally* Weller *supra*; Howard, *supra* note 6.

McCarran provides in part:

§ 1011. Declaration of policy

Congress hereby declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.

§ 1012. Regulation by state law; Federal law relating specifically to insurance; applicability of certain Federal laws after June 30, 1948

(a) **State regulation**

The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

(b) **Federal regulation**

No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance * * * unless such Act specifically relates to the business of insurance.

dential Ins. Co. v. Benjamin, 328 U.S. 408 (1946). In the first construction of McCarran essayed by this Court, Justice Rutledge (writing for a unanimous Court) addressed the Congressional intent that gave rise to the Act:

> Obviously Congress' purpose was broadly to give support to the existing and future state systems for regulating and taxing the business of insurance. This was done in two ways. One was by removing obstructions which might be thought to flow from its own power, whether dormant or exercised, except as otherwise expressly provided in the Act itself or in future legislation. [footnote omitted] The other was by declaring expressly and affirmatively that continued state regulation and taxation of this business is in the public interest and that the business and all who engage in it "shall be subject to" the laws of the several states in these respects.

Id. at 430-31.

He continued, exploring the significance of Congress' knowledge of state insurance laws at the time it enacted McCarran:

> (I)n taking this action Congress must have had full knowledge of the nation-wide existence of state systems of regulation and taxation; of the fact that they differ greatly in the scope and character of the regulations imposed and of the taxes exacted; and of the further fact that many, if not all, include features which, to some extent, have not been applied generally to other interstate business. Congress could not have been unacquainted with these facts and its purpose was evidently to throw the whole weight of its power behind the state systems, notwithstanding these variations. *Id.* at 430.[16]

[16] Presumably Congress also was aware of the existence of FPS and of what was then Section 22 of the Bankruptcy Act of 1898, 11 U.S.C. § 22 (repealed 1978), which made domestic insurance companies ineligible for federal bankruptcy.

Thus, this Court immediately recognized the broad "preemptive" effect of state regulation of the business of insurance intended by Congress under McCarran. What remained was to ascribe a meaning to the "business of insurance."

2. This Court Correctly Construed the "Business of Insurance" For the Primary Purpose of McCarran in the *National Securities* Decision.

The most enduring effort by this Court to define the "business of insurance" under McCarran was undertaken in *SEC v. National Securities, Inc.*, 393 U.S. 453 (1969). Unlike later cases of this Court construing the "business of insurance" (*e.g., Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982); *Group Life & Health Ins. Co. v. Royal Drug Co.*, 441 U.S. 917 (1979)), *National Securities* interpreted the "business of insurance" in the context of the primary purpose of McCarran—preserving the role of the states as regulators of the business of insurance. In distinction, *Pireno* and *Royal Drug* involved the Act's secondary purpose of delineating the applicability of federal antitrust laws.

In *National Securities*, this Court upheld the Petitioner SEC's contention that the anti-fraud provisions of the federal securities laws applied in the context of the merger of two insurance companies. Arizona insurance laws required prior approval of the merger by the Arizona Director of Insurance. Respondents argued that the state law would have been "superseded" by application of the federal securities laws. The threshold question for the Court was whether the state law was a "law enacted . . . for the purpose of regulating the business of insurance" under McCarran. 393 U.S. at 457. The Court held that the state law did not regulate the business of insurance, but rather

addressed the relationship between the involved corporations and their stockholders. *Id.* at 460. Consequently, the federal securities laws applied, notwithstanding the "reverse-preemption" rule of McCarran.

Writing for a divided Court, Justice Marshall carefully considered the question of what was intended to have been protected by McCarran: "The statute did not purport to make the States supreme in regulating all the activities of insurance *companies*; its language refers not to the persons or companies who are subject to state regulation, but to laws 'regulating the *business* of insurance.' " 393 U.S. at 459 (emphasis in original). Examples of regulating the "business of insurance" included the fixing of rates, as upheld in *South-Eastern Underwriters*; the sales and promotion of policies, under *FTC v. National Casualty Co.*, 357 U.S. 560 (1958); and the licensing of companies and agents, as in *Robertson*. As Justice Marshall explained:

> Congress was concerned with the type of state regulation that centers around the contract of insurance, the transaction which *Paul v. Virginia* held was not "commerce." *The relationship between insurer and insured, the type of policy which could be issued, its reliability, interpretation, and enforcement—these were the core of the "business of insurance."* Undoubtedly, other activities of insurance companies relate so closely to their status as reliable insurers that they too must be placed in the same class. But *whatever the exact scope of the statutory term, it is clear where the focus was—it was on the relationship between the insurance company and the policyholder. Statutes aimed at protecting or regulating this relationship, directly or indirectly are laws regulating the "business of insurance."*

393 U.S. at 460 (emphasis added).

3. Under *National Securities*, Ohio's Priority Statute Regulates the "Business of Insurance".

The Receiver submits that the issue here is easily resolved in Respondent's favor by reference to this Court's description of the "core" and "focus" of McCarran in *National Securities*. Under that description, it is difficult to view the Ohio statute as anything other than a law regulating the business of insurance.

In *National Securities*, the Court referred to three different categories of activities that were within the "business of insurance"—"core" matters; matters within the "focus" of the statutory term, although not necessarily "core" activities; and "other activities" of insurance companies sufficiently related to their status as reliable insurers that they must be classified as part of the "business of insurance." 393 U.S. at 460. The Court described "core" matters as "the relationship between insurer and insured, the type of policy which could be issued, its reliability, interpretation, and enforcement." *Id.* The "focus" of the term is "the relationship between the insurance company and the policyholder." *Id.* As Justice Marshall wrote, "(s)tatutes aimed at protecting or regulating this relationship, directly or indirectly are laws regulating the 'business of insurance.' " *Id.* The Court did not specifically define "other activities," but indicated that they must relate significantly to the status of a company as a reliable insurer. *Id.*

Under the *National Securities* "core" concept, the Ohio priority statute regulates the relationship between the insurer and insured, and deals directly with the reliability and enforcement of policies issued by the company in re-

ceivership.[17] The overriding goal of the state's regulatory system—the "seamless web" referred to above—is to protect the policyholder's expectation of coverage. The priority provisions, part of that system, are directed at achieving the goal of protecting policyholders. The Ohio legislature effectively has told the policyholder of an Ohio insurer that, even if the insurer is liquidated, his policy nonetheless may be reliable and enforceable because of the statutory priority that policyholders have to the assets of the issuing company.[18]

Similarly, the Ohio priority statute falls within the "focus" of McCarran. The only conceivable purpose and effect of the statutory priority for policyholders is to protect directly the prospect that the policyholder will be

[17] Of course, "interpretation" of the same policies is also implicated under a closely related Ohio statutory provision. The Liquidator must evaluate the merits and amounts of claims under policies issued by the company before making distributions according to the statutory priorities. Ohio Rev. Code Ann. §3903.43 (Anderson 1989).

[18] In two Circuit Court cases involving FPS, the courts have been unable to recognize the focus on policy reliability and enforcement reflected in state liquidation priority provisions. *Idaho ex rel. Howard v. United States*, 858 F.2d 445 (9th Cir. 1988), *cert. denied*, 490 U.S. 1065 (1989); *Gordon v. United States Dep't of the Treasury*, 668 F. Supp. 483 (D. Md. 1987), 846 F. 2d 272 (4th Cir. 1988), *cert. denied*, 488 U.S. 954 (1988). Perhaps this result followed an unnecessary effort by the courts to force the facts of the cases into the matrix prescribed for antitrust cases under *Pireno*.

The Receiver suggests that these courts were further confused by their tacit assumptions that the priority statutes at issue had no significance until *after* a company was in liquidation. In fact, the priority provisions, comparable to the mandatory provisions of state corporation law, provide implicit terms of insurance contracts that inure to the benefit of a policyholder from the day his policy is issued. *See Chicago Life Ins. Company v. Needles*, 113 U.S. at 584; *Cf.* Easterbrook and Fischel, *supra note* 14, at 5-6, 14.

paid, from assets of the company, claims covered by the policy that the company issued to him.

This case differs in one significant respect from both *National Securities* and the two deceptively similar antitrust decisions of this Court, *Pireno* and *Royal Drug*. This is not a "business of insur*ers*" case. In each of those three cases, an active insurance company unsuccessfully invoked McCarran to avoid the effect of federal law for a corporate advantage divorced from its relationship with policyholders.[19] The Ohio priority statute now before this Court is a matter of virtual indifference to the operators of active companies to which it might someday apply.[20]

In sum, the Ohio priority statute directly benefits policyholders rather than insurers. The distribution priority it affords over other estate claimants presumably reflects the Ohio legislature's judgment that policyholders are different from other creditors of an insurance company and should receive special treatment.[21]

[19] In *National Securities*, companies subject to state insurance regulation sought to assert the Arizona insurance law as a shield against merger disclosure requirements of the federal securities laws; in *Royal Drug*, defendants in a civil antitrust case tried to show that Texas insurance laws rendered federal law inapplicable to contracts entered into with pharmacies participating in a discount arrangement; similarly, in *Pireno*, civil antitrust defendants claimed that New York insurance laws rendered the voluntary use by a health insurer of a professional review panel beyond the reach of the federal antitrust laws.

[20] The Ohio law provides for distribution of remaining assets to shareholders after all higher-priority claims have been paid. *See* Ohio Rev. Code Ann. §3903.42(H) (Anderson 1989). Needless to say, such distributions seldom are made. *See* Howard, *supra note* 6, at 13.

[21] *See* Kimball, *supra*, at 33.

4. Application of the *National Securities* Holding in this Case Gives Effect to the Primary Goals of McCarran.

For several reasons, the Receiver urges this Court to apply the "business of insurance" test set forth in *SEC v. National Securities, Inc.*, 393 U.S. 453 (1969), notwithstanding the Court's later rulings in *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982), and *Group Life & Health Ins. Co. v. Royal Drug Co.*, 441 U.S. 917 (1979).

First, as noted above, McCarran had two purposes, addressed in distinct parts of the Act. The first purpose was broadly to preserve the authority of the states to tax and regulate the business of insurance, except to the extent of federal laws expressly intended to affect that business. *Prudential Insurance Co. v. Benjamin*, 328 U.S. at 430-31. The ancillary purpose of the Act was to clarify the applicability of the federal antitrust laws to the insurance business.[22] *National Securities* interpreted "business of insurance" in the context of McCarran's primary purpose; *Pireno* and *Royal Drug* interpreted the same words for the narrow, ancillary purpose of determining federal antitrust jurisdiction. The instant case involves McCarran's principal purpose—defining the boundaries of the insurance regulatory powers of the State of Ohio.

More significantly, the *Pireno* and *Royal Drug* standards were crafted to do a narrow, specific job. They seem crabbed, mechanical, and talismanic when offered for the purpose of defining the scope of McCarran's broad grant of authority to the states. As Justice Rutledge wrote in *Prudential*, the purpose of Congress in enacting McCarran ". . . was evidently to throw the whole weight of its power behind the state systems." 328 U.S. at 430. The broad, flexible standards set forth in *National*

[22] Howard, *supra* note 6 at 79.

Securities best give effect to that intent, at least in cases outside of the antitrust area.

The Receiver recognizes that courts eschew ascribing different meanings to similar or identical terms within a statute. However, this "rule of consistency" is merely a principle of statutory construction, not a substantive rule of law. *See* Howard, *supra note* 6, at 83; *see also Pireno v. New York State Chiropractic Assoc.*, 650 F.2d 387, 394 n.12 (2nd Cir. 1981), *rev'd sub nom. Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982). To the extent this Court wishes to preserve for antitrust purposes the analysis reflected in *Pireno* and *Royal Drug*, the Court should consider the proposal of commentators, noted in the lower federal courts, that the "business of insurance" be interpreted according to different standards, depending upon the specific provision of McCarran at issue.[23] Here, the primary purpose of McCarran is involved, and an interpretation of the "business of insurance" consistent with that broad Congressional purpose should be employed.

CONCLUSION

Long before Congress enacted McCarran, states administered receiverships of troubled insurers. By adopting McCarran, Congress reaffirmed its long-standing conclusion that the states are responsible for the regulation of insurance companies. The Ohio statute in this case mere-

[23] *See, e.g.*, Howard, *supra note* 6 at 83; Note, *The Definition of 'Business of Insurance' Under the McCarran-Ferguson Act After Royal Drug*, 80 Colum.L.Rev. 1475, 1479-81 (1980). *See also Pireno v. New York State Chiropractic Assoc.*, 650 F.2d 387, 394 n.12 (2nd Cir. 1981); *rev'd sub nom. Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982); *Lyons v. United States*, No. 4-91-10209; 1992 U.S. Dist. LEXIS 11714 at *5 n.3 (S.D. Iowa July 2, 1992).

ly establishes priorities for distribution of the assets of insolvent companies within the seamless web of Ohio's regulatory framework. Effective state regulation of operating companies is inextricably intertwined with state laws regarding insurance receivership. Petitioners' attempt to impose the restrictions of FPS on state receivers would have the practical consequence of seriously impairing receivers in the performance of their statutory obligations. The economic benefit to the federal government of the revenues generated by such a result would be far outweighed by the negative consequences to the intended beneficiaries of receivership laws (primarily policy owners and beneficiaries).

In its *National Securities* decision, this Court established a standard defining the "business of insurance" for purposes of McCarran that should be applied in this case. Under that standard, state regulation affecting the relationship between the insurer and insured, and the enforcement and reliability of insurance policies, was held to be the "core" of the business of insurance. Ohio's priority statute is designed specifically for the purpose of ensuring the enforcement and reliability of a troubled insurer's obligations under its policies.

For the foregoing reasons, the decision of the Sixth Circuit should be affirmed.

Respectfully submitted,

Peter G. Gallanis
Counsel of Record
Chief General Counsel to the Director, as Receiver
Office of the Special Deputy Receiver
222 Merchandise Mart Plaza
Chicago, Illinois 60654
(312) 836-9500

Counsel for Amicus Curiae

16

No. 91-1513

In The
Supreme Court of the United States
October Term, 1992

UNITED STATES DEPARTMENT
OF THE TREASURY AND
MITCHELL A. LEVINE, ASSISTANT COMMISSIONER,
Petitioners,

v.

GEORGE FABE, SUPERINTENDENT OF
INSURANCE STATE OF OHIO,
Respondent.

**On Writ Of Certiorari
To The United States Court Of Appeals
For The Sixth Circuit**

**BRIEF FOR THE NATIONAL ASSOCIATION
OF INSURANCE COMMISSIONERS;
AS AMICI CURIAE IN SUPPORT OF RESPONDENT**

Susan E. Martin
General Counsel
120 West 12th Street, Suite 1100
Kansas City, Missouri 64105
Phone: (816) 842-3600

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

QUESTION PRESENTED

The federal priority statute, 31 U.S.C. § 3713(a), calls for debts owed to the United States by an insolvent person to be paid first.

Ohio Rev. Code Ann. § 3903.42 provides that claims of the United States are accorded "Class 5" priority, below administrative expenses, employee wages, policyholder claims, and general creditor claims, in state court proceedings to liquidate an insolvent insurer.

Federal preemption nullifies the operation of the Ohio statute, requiring a state court appointed liquidator to pay the claims of the United States ahead of all other creditors, including policyholders, unless the state statute is subject to the anti-preemption provisions of the McCarran-Ferguson Act, 15 U.S.C. § 1012.

The question presented is:

> Whether a state statute establishing the priority of claims in a state court proceeding to liquidate an insolvent insurer is a law regulating "the business of insurance" within the meaning and intent of the McCarran-Ferguson Act.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page

CASES:

TABLE OF AUTHORITIES – Continued

Page

CONSTITUTION AND STATUTES:

TABLE OF AUTHORITIES – Continued

No. 91-1513

In The

Supreme Court of the United States

October Term, 1992

UNITED STATES DEPARTMENT
OF THE TREASURY AND
MITCHELL A. LEVINE, ASSISTANT COMMISSIONER,

Petitioners,

v.

GEORGE FABE, SUPERINTENDENT OF
INSURANCE STATE OF OHIO,

Respondent.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Sixth Circuit

BRIEF FOR THE NATIONAL ASSOCIATION
OF INSURANCE COMMISSIONERS;
AS AMICI CURIAE IN SUPPORT OF RESPONDENT

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Sixth Circuit is reported at 939 F.2d 341. The opinion of the district court is unreported.

JURISDICTION

The jurisdiction of this Court rests on 28 U.S.C. § 154(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

31 U.S.C. § 3713; 15 U.S.C. §§ 1011, 1012; 11 U.S.C. § 109; and Ohio Rev. Code Ann. (Anderson 1989) §§ 3903.02, 3903.03 and 3903.42 are all reproduced as appendix to this brief.

STATEMENT

On April 30, 1986, the Court of Common Pleas for Franklin County, Ohio declared American Druggists' Insurance Company insolvent and, pursuant to Ohio Rev. Code Ann. § 3903, ordered the company be liquidated. Respondent was appointed to serve as liquidator.

The United States filed various claims with Respondent against American Druggists' based on its capacity as obligee in certain immigration, appearance, performance and payment bonds issued by American Druggists' as surety when it was solvent. The United States also notified Respondent that it asserted a superpriority for payment of its claims pursuant to 31 U.S.C. § 3713(a)(1)(A).

Respondent filed suit in federal district court seeking a declaratory judgment that the United States' priority for its claims was controlled by the applicable Ohio statute governing priorities for claims filed against an insurance

company in liquidation, Ohio Rev. Code Ann. § 3903.42, not the federal insolvency statute because the Ohio statute is a state law regulating "the business of insurance" within the meaning and intent of the McCarran-Ferguson Act, 15 U.S.C. § 1012(b).

The federal district court entered judgment for the United States concluding that the Ohio statute regulated only the business of insurance companies, not "the business of insurance." The district court relied on this Court's three-part test for determining whether an activity is "the business of insurance" within the meaning of the McCarran-Ferguson Act as set out in *Union Labor Life Insurance Co. v. Pireno*, 458 U.S. 119, 129 (1982).

Respondent appealed the district court's judgment to the United States Court of Appeals for the Sixth Circuit. That Court reversed the judgment of the district court finding that the applicable Ohio statute is a law regulating "the business of insurance" within the meaning of the McCarran-Ferguson Act, also relying on the three-part test set out in *Pireno*, but looking to two earlier decisions of this Court in applying the *Pireno* test to the state regulation at issue in this case, *Securities & Exchange Commission v. National Securities*, 393 U.S. 453 (1969), and *Group Life & Health Insurance Company v. Royal Drug Company*, 440 U.S. 205 (1979).

The United States filed a petition for writ of certiorari in this Court for a review of the judgment of the Court of Appeals. Such writ was granted on May 18, 1992.

INTEREST OF THE AMICI CURIAE

The parties amici curiae bringing this brief to this Court consist of the National Association of Insurance Commissioners and its members.

The National Association of Insurance Commissioners (the "NAIC") is a non-profit legal association whose members are the chief insurance regulators in each state, territory and the District of Columbia. The NAIC's purpose is to serve the public by assisting these regulatory officials and includes the following fundamental insurance regulatory objectives set out in its constitution:

(1) maintenance and improvement of State regulation of insurance in a responsive and efficient manner;

(2) reliability of the insurance institution as to financial solidity and guarantee against loss; and

(3) the fair, just and equitable treatment of policyholders and claimants.

The NAIC provides services to its members through, among other things, the development and adoption of "model laws." These "model laws" serve as standards for the members of the NAIC in carrying out their responsibilities. The NAIC has adopted the "Insurers Rehabilitation and Liquidation Model Act," NAIC Model Laws, Regulations and Guidelines, 555-1 *et seq.* ("the Model Act") to serve as a guidepost for its members in discharging their statutory and court-ordered duties as rehabilitators and/or liquidators of financially troubled or insolvent insurers. The Model Act provides for uniformity in the approach to rehabilitation and liquidation as well as uniformity in the treatment of the policyholders, claimants and creditors of such insurers. The relevant

Ohio statute, Ohio Rev. Code Ann. § 3903.02 *et seq.*, is similar in its substance to the Model Act, as are most other states' rehabilitation and liquidation laws.

The Model Act expresses as its purposes, among other things, the protection of insureds, claimants, creditors and the public generally through improved efficiency and economy of activities, uniformity among the various states' activities with respect to insurer insolvency, clarification of the law, *regulation of the insurance business* by the impact of the law relating to insurer delinquency procedures and substantive rules on the entire *insurance business* (emphasis added). Model Act, 555-2.

The Model Act contains provisions governing the priority for distribution of the assets of an insolvent insurer. The Ohio statute, which is at issue in this case, is patterned after the Model Act. The Act places claims of the federal government in Class 5 priority (unless such claims qualify for class 3 priority (policyholders)), after administrative expenses, employee wages, policyholder claims and general creditor claims. Model Act, 555-32, 33.

The other participants in this brief are members of the NAIC and have a common interest with the Respondent and the NAIC in the protection *first* of policyholders and claimants under policies of insurance in the unfortunate circumstances of insurer insolvency.

The resolution of the question submitted is of extraordinary importance to state insurance regulatory officials, solvent insurers, policyholders and claimants under policies of insurance, state guaranty associations, state law-making bodies, and the tax paying public in general.

SUMMARY OF ARGUMENT

The enactment of the McCarran-Ferguson Act confirms and ensures the intent of the United States Congress that the traditional policy of state regulation of the business of insurance be maintained and protected. However, the Congress offered no definition for, and legislative history does not clearly illuminate the meaning of the term "the business of insurance" as used in the McCarran-Ferguson Act. *National Securities,* 393 U.S. at 459. An analysis of the applicable state laws relevant federal statutes, and case law, plus an elaboration on the activities and practices of state liquidator lead to the conclusion that federal law does not preempt state law in the instant case.

1. State Regulation

The purpose of the Ohio statute at issue, like the Model Act, is the protection of policyholders. The special elevated priority assigned to policyholders' claims under policies of insurance is inextricably and clearly tied to the relationship between the insolvent insurer and the policyholder. In the absence of the insurer/policyholder relationship, there is no basis for the priority statute application. This is true because the primary purpose of the statute, as well as the Model Act, is the protection of policyholders and claimants under policies of insurance.

In a state-court ordered liquidation of an insolvent insurer, the chief insurance regulatory official of the state is appointed by the state court as the liquidator. Model Act, 555-3. As such, he takes on a new legal capacity, separate and distinct from the role as regulatory official.

It is said that he "steps into the shoes of the insurer." He acts as though he/she were the insurer in dealing with the affairs of the insurer. He becomes the insurer, taking on its identity. The insurer/policyholder relationship is continued and protected by the liquidator. The liquidator is obligated to receive, adjust and pay claims filed by policyholders or claimants under policies as though he were the insurer. The liquidator is bound by the terms of the insurance contract. Such contracts are not automatically canceled upon entry of a court order placing an insurer in liquidation and appointing a liquidator. The relationship that exists between policyholder and insurer does not cease; the only difference is that the management of the insurer is replaced with the liquidator, whose capacity is the same as the insurer. Model Act, 555-14-19.

2. The Supreme Court "trilogy"

a. In *National Securities,* a non-antitrust case, the SEC sought to reverse a merger of two Arizona insurers based upon material misrepresentations to shareholders of one of the companies. The merger was accomplished pursuant to Arizona law. Justice Marshall wrote that the applicable Arizona law regulated the relationship between insurers and their shareholders, not insurers and their policyholders, and thus did not regulate "the business of insurance." *National Securities,* 393 U.S. at 460. He concluded that "the relationship between insurer and insured – the type of policy which could be issued, its reliability, interpretation, and enforcement . . . these were the core of "the business of insurance," and "it is clear where the focus was – it was on the relationship between the insurance company and the policyholder." *Id.* With these words, Justice

Marshall resolved the question of the meaning and intent of Congress in the enactment of McCarran-Ferguson and its use of the term "the business of insurance." "Statutes aimed at protecting this relationship, directly or indirectly, are laws regulating 'the business of insurance'." *Id.*

b. The second case in the trilogy, *Royal Drug*, was an antitrust case involving alleged anticompetitive provider agreements between a Texas insurer and a number of pharmacies. Several nonparticipating pharmacies sued the insurer claiming a violation of the Sherman Antitrust Act. This Court again focused on the relationship between the insurer and the policyholder in its analysis of "the business of insurance." The opinion held that the provider agreements at issue in the case did not serve to spread or underwrite policyholder risk, did not directly involve the relationship between the insurer and the insured, established when the policy is issued, and did not involve only parties within the insurance industry, but rather constituted nothing more than contracts for goods and services between the insurer and the pharmacies. *Royal Drug*, 440 U.S. at 216. The applicable Texas law, which required prior approval of insurance policies, did not regulate these related provider agreements, and the practice was not exempt from the operation of the Sherman Antitrust Act. *Id.* Justice Stewart's opinion elaborated beyond the broader meaning of "the business of insurance" iterated by Justice Marshall in *National Securities* and applied a narrower analysis to the facts of *Royal Drug*.

c. In the last case, *Pireno*, this Court applied the *Royal Drug* test to the relevant facts which involved a peer review process in which the insurer routinely

accepted a state chiropractic association's recommendations for payment to licensed chiropractors as reasonable and necessary treatment for its policyholders. A chiropractor whose patients were not being reimbursed because the association was not recommending payment sued alleging violations of the Sherman Antitrust Act. As in *Royal Drug*, the other antitrust case in the trilogy, this Court used the narrow test to determine whether or not the peer review process constituted "the business of insurance" as intended by the McCarran-Ferguson Act. *Pireno*, 458 U.S. at 129. The Court again, as in *Royal Drug*, concluded that the peer review process was not "the business of insurance." *Id.* at 126.

These three cases form the wellspring from which many lawsuits have emerged. The attempts to reconcile them have been largely unsuccessful primarily because the earliest of the three, *National Securities*, is a non-antitrust case.

3. The Bankruptcy Exclusion

The protection of the insurer/policyholder relationship is the paramount reason that insurance companies are excluded from the operation of federal bankruptcy law. 11 U.S.C. § 109. Congress recognized the need to continue to afford the policyholder special protection in the event of the bankruptcy – insolvency – of his insurance company and provided for that protection by leaving to the states the primary role in regulating "the business of insurance" under the provisions of the McCarran-Ferguson Act.

ARGUMENT

1. The Ohio Statute Is A Law Regulating "The Business Of Insurance" Within The Meaning And Intent Of The McCarran-Ferguson Act.

This case may be summed up in the above single statement. The Ohio statute governing the supervision, rehabilitation and liquidation of an insolvent insurer doing business in Ohio provides the framework for the administration of the "estate" (referring generically to the totality and nature of interest the insurer has in real or personal property) of the insolvent insurer. Its greater purpose is stated as "the protection of the interests of insureds, claimants, creditors, and the public generally . . . " Ohio Rev. Code Ann § 3903.02(D). This purpose is accomplished through a number of activities including the "[E]quitable apportionment of any unavoidable loss . . . ," Ohio Rev. Code Ann. § 3903.02(D)(4), and "[R]egulation of the insurance business by the impact of the law relating to delinquency procedures and substantive rules on the entire insurance business." Ohio Rev. Code Ann. § 3903.02(D)(6).

Generally, state regulation of insurance constitutes regulation of the birth, life and death of an insurer. Comprehensive laws and related regulations provide for the formation of an insurer and authorization for it to begin transaction of the business of insurance within a state's jurisdiction. Throughout the usually long life of an insurer, state regulation continues over the activities of the insurer, including, for example, the issuance of insurance policies and the payment of claims thereunder; the relationship of the insurer with its policyholders, such as

the duty of utmost good faith; the activities an insurer engages in with its parent, subsidiaries and other affiliates; the types of policy and other forms the insurer utilizes; the rates of premiums the insurer charges; the types and nature of assets an insurer may report and take credit for on its financial filings; and the volume of policy reserves an insurer is required to maintain, etc.

In the infrequent case of the termination of an insurer due to insolvency (its death), state regulation again controls the timing of delinquency proceedings, Model Act, 555-3 (a generic reference to a judicial or administrative action initiated by the insurance regulator against an insurer for the purpose of liquidating, rehabilitating, reorganizing or conserving the insurer; "delinquency" refers to some failure, omission or violation of law or duty) the nature of the delinquency proceedings, the methods and means of disposal of the insurer's assets and liabilities, and provides for funding of expenses and payment of claims. It is in this latter category that the priority for distribution of assets falls. The priority for distribution of assets is an integral part of the regulation of the death of an insurer since it controls which parties are paid and the order of payment. Statutory regulation of delinquency proceedings is a special, comprehensive plan enacted for the specific purpose of regulating the business of the insurance, even though the end result is the death of an insurer and the cessation of the transaction of the business of insurance by the subject insurer. The activity of paying claims pursuant to a priority statute is only one part, albeit an integral one, of the overall plan, the purpose of which ultimately is the protection of

policyholders and policy claimants before other types of creditors.

"The business of insurance," which forms the activities of state regulation of delinquency proceedings, passes the test articulated by Justice Marshall and applied to a non-antitrust set of facts in *National Securities*. That same test applied to the facts of the instant case produces the same result. An analysis of the nature of the activities of a liquidator and the goals of liquidation clearly leads to that result.

A state court-appointed liquidator takes over the insolvent insurer and assumes its management from the officers and directors. Throughout the conduct of the liquidation, the state court acts as the ultimate authority for all activities of the liquidator. The liquidator controls and operates the day to day activities of the insurer, including the ongoing relationships with the insurer's policyholders. The insurance policies become an obligation of the liquidator and do not automatically terminate on liquidation. The liquidator is subject to the agreements made in the policies by the insurer. The insurance company continues to exist and its corporate charter is not revoked. The liquidator performs his duties in different capacity than that of a commissioner or regulator. The liquidator has a fiduciary relationship with the policyholders and must treat them fairly, equitably, and with a high degree of fidelity. To that end, he must promptly determine coverage under policies, adjust claims accordingly, and pay those proper claims utilizing assets of the insurer which have come into his possession. He takes title in his own name to such assets. These activities are inextricably involved in the relationship between the

insurer and the policyholder. State liquidation laws were enacted for the best interests of all creditors, but primarily were intended to protect the policyholder first from the harm attendant to insolvency. The rationale behind this intent is the unique relationship between insurer and policyholder. Generally, Model Act, 555-1-38.

The business of insurance specializes in the acceptance of risk. Certain risks of substantial financial losses or damages are unmanageable or unacceptable to the insurance consuming public. It seeks to transfer those risks, for consideration, to others who are more able to absorb the damages. Those who are in the business of insurance accept these financial risks and develop means of managing them and similar other risks, forming an industry which serves public and social interests. This is not a goods and services industry. At the center of the risk transferring and accepting activity is the ability of those in the business of insurance to pay under the terms of the policy when a claim is filed. The consideration, or the premium, forms the security for more funds to be available for payment to the policyholder in the event a claim is filed. *Managing Insurer Insolvency*, Prepared by Stewart Economics, Inc.; November, 1988; National Association of Insurance Brokers.

Clearly, where a liquidator steps into the shoes of the insurer, the risk accepted by the insurer becomes the risk of the liquidator. The assets available to the liquidator must be marshaled and used to pay claims, after claims are filed and adjusted. Ohio Rev. Code Ann. § 3903.42 transfers the risk of insolvency to the liquidator and spreads it among other policyholders and creditors of the insurer within certain prioritized classes. These activities

are integral to the relationship between the policyholder and the insurer, or the liquidator, and are key elements in the business of insurance. *Fabe v. U.S. Treasury*, 939 F.2d 341, 351 (6th Cir. 1991).

Since state liquidation laws treat policyholders with a special emphasis, they are not considered ordinary creditors by liquidators. The liquidation priority statutes were drafted with policyholders' special needs in mind. Other creditors do not have the same needs. Managing the risk for catastrophic financial damages to a policyholder is the primary focus of the state legislatures in prioritizing policyholders in a class above other creditors of insurers. The intent was to protect the policyholders and protect the unique relationship between policyholder and insurer, or liquidator, where the liquidator is the insurer.

Policyholders and other non-policyholder creditors are included in state insurer liquidation priority designs; however, policyholders occupy an elevated status and must be paid in full if assets are sufficient before non-policyholders creditors' claims are even evaluated and/or paid. If assets are not sufficient, policyholders must be paid proportionately until all assets are exhausted. Policyholders are special claimants and are not categorized with other creditors. The fact that other creditors are provided for in the priority statutes and are eventually dealt with by the liquidator in the process of liquidation does not lessen the special treatment afforded policyholders or alter the special class they occupy. Clearly, based on these factors the priority statute is a law regulating "the business of insurance."

There is support in case law for the proposition that the activities of a liquidator and the liquidation process itself is "the business of insurance." Even though these cases are based on abstention issues and do not address the *Pireno* analysis, they provide persuasive authority for the argument. See, e.g. *Gerald Grimes v. Crown Life Insurance Co.*, 857 F.2d 699 (10th Cir. 1988), cert. denied, 489 U.S. 1096 (1989); *Levy v. Lewis*, 635 F.2d 960 (2d Cir. 1980); *Washburn v. Corcoran*, 643 F. Supp. 554 (S.D.N.Y. 1986). One case did recognize the effect of *Pireno* on liquidation proceedings. *United Services Auto Association v. Muir*, 792 F.2d 356 (3d Cir. 1986), cert. denied *sub nom. Grode v. United Services Auto Association*, 479 U.S. 1031 (1987). The court there found that liquidation had a direct bearing upon the relationship between the insurer and the policyholder, using the facts in *Levy* stating, "the state regulation implicated in *Levy* concerned both the future coverage of policyholders and their relationship with a defunct insurer, and so were authorized under McCarran-Ferguson . . . " *Muir*, 792 F.2d at 364.

2. The *National Securities* Broad Test Should Be Applied To The Facts Of The Instant Case.

The distinction between the *National Securities* test and the *Royal Drug/Pireno* test was recognized by at least one jurist in the Second Circuit when *Pireno* was decided at that level. Circuit Judge Kearse wrote that "the phrase 'the business of insurance' may have a broader meaning in those provisions of the McCarran-Ferguson Act that preserve state insurance laws from federal preemption than it does in the antitrust exemption [and] this duality

of meaning [may] explain [] the apparent inconsistency of *Royal Drug*, which interpreted the exemption, with earlier cases that interpreted other exemptions." *Pireno*, 458 U.S. at 394, n. 12.

The difference in meaning between the provisions of the McCarran-Ferguson Act which preserve state regulation and those which exempt activities from federal antitrust laws is at the heart of the instant case. The enactment of the McCarran-Ferguson Act served as a compromise between the position on the one hand that insurance was interstate commerce subject to federal regulation (*U.S. v. South-Eastern Underwriters Association*, 322 U.S. 533 (1944)) and the concerns that the federal government would not take effective action to regulate the "business of insurance" as interstate commerce. The NAIC developed, drafted and proposed the bill which ultimately was passed into law. That legislation sought to preserve and maintain continued state regulation of the business of insurance but retain the application of federal antitrust laws. 1944 Proceedings of the NAIC, 54-55, and 1945 Proceedings of the NAIC, 23-49.

The legislative intent behind the McCarran-Ferguson Act and the trilogy of cases out of this Court interpreting "the business of insurance," properly applied to the facts of the instant case, lead to the inevitable result that the federal superiority statute is not controlling over the liquidation of insolvent insurers by the states or the state priority statutes for distribution of an insolvent insurer's assets in a liquidation.

In *Royal Drug*, the Court recognized that the enactment of the McCarran-Ferguson Act served two purposes

intended by Congress: first to ensure that the States continue to tax and regulate the business of insurance, and second, to provide a limited antitrust exemption to insurance companies. *Royal Drug*, 440 U.S. at 217-218. The two purposes are expressed at 15 U.S.C. § 1011 and § 1012(a) and (b).

There are two separate and distinct sections of the McCarran-Ferguson Act applicable to these two purposes. The term "the business of insurance" appears in both sections. Given the dual purposes of the Act, the term has been interpreted differently. The first purpose guarantees States the right to regulate "the business of insurance" generally and to enact state laws for that purpose free from preemption by any general federal law in conflict. The second purpose ensures that insurance companies, even though regulated by the States, would not escape federal antitrust regulation completely.

Given the dual purposes of the Act, the Court has defined "the business of insurance" different ways in two different areas: the non-antitrust and the antitrust.

The general intent of the McCarran-Ferguson Act, as well as the plain language in the absence of the antitrust, is implicated in the broad definition articulated by the Court in *National Securities*. In the context of what is called the "antitrust proviso" of McCarran-Ferguson, the Court has developed a three-pronged test to determine whether the challenged activities are "the business of insurance." *Royal Drug*, 440 U.S. at 214-215; *Pireno*, 458 U.S. at 129. These two different definitions and tests are entirely appropriate given the distinctions made in McCarran-Ferguson itself.

The notion that "the business of insurance" has a broad definition in the context of a non-antitrust case is not new. Writers have suggested that application of the narrow *Royal Drug/Pireno* definition in cases which do not come within the purview of the "antitrust proviso" is an inappropriate limitation. Application of the traditional rule of consistency in statutory construction would subvert legislative intent and has brought about catastrophic results for states and policyholders, who will find their entitlements to their insurer's assets stripped away by a federal bureaucracy. See Davis Howard, *Uncle Sam Versus The Insurance Commissioners: A Multi-Level Approach to Defining the "Business of Insurance" Under The McCarran-Ferguson Act*, 25 Willamette Law Review 1, 79 (1989).

Courts have also referred approvingly to this "multi-definitional analysis." *Lyons v. United States*, No. 4-91-10209, slip op. at 7 n.3 (S.D. Iowa July 2, 1992). See also *State of Idaho ex rel. Soward v. United States*, 858 F.2d 445 (9th Cir. 1988), cert. denied *sub nom. Fagiano v. U.S.*, 490 U.S. 1065 (1989) at 453. Even the Second Circuit in its *Pireno* ruling agreed that different definitions of the term "the business of insurance" is appropriate, given different challenged activities. *Pireno*, 458 U.S. at 394, n.12.

3. The Federal Bankruptcy Exclusion Illustrates Congressional Intent Of McCarran-Ferguson To Protect Policyholders First.

An insurance company cannot initiate a voluntary bankruptcy proceeding. 11 U.S.C. § 109(b)(2) and (d). Nor can creditors of an insurance company, whether of the policyholder category or otherwise, initiate involuntary

bankruptcy proceedings against an insurance company. If the initiation of delinquency proceedings against an insurer by a state regulatory official resulted in a conversion of the insurer to an ordinary corporation/debtor subject to federal bankruptcy laws then the federal priority statute would still be inapplicable. 31 U.S.C. § 3713(b). Policyholders do not lose their special entitlements as a special class of creditors and are not converted into ordinary creditors to be dealt with at the same time as all other non-policyholder creditors. Policyholder protection and the preservation of state regulation over the entire state liquidation procedure were the goals when Congress exempted insurers from the application of federal bankruptcy laws. If the federal priority statute were held to apply to insurers, then delinquency proceedings against an insurer would, have less meaning than an ordinary corporate bankruptcy. Policyholders of an insolvent insurer would have less protection than ordinary creditors of a corporation in bankruptcy. States would be rendered incapable of providing the special protection needed by policyholders to minimize financial loss and to realize the benefits of their bargain when they purchased insurance coverage. *Davis v. Pringle*, 1 F.2d 860 (4th Cir. 1924), aff'd, 268 U.S. 315 (1925), 864 and *Sims v. Fidelity Assurance Association*, 129 F.2d 442 (4th Cir. 1942) aff'd on other grounds, 318 U.S. 608 (1943), 448-449. Certainly these unseemly results were not contemplated or intended by Congress. The opposite, in fact, is true: Congress intended that states would step in and enact laws and regulations to provide special protection and treatment for policyholders.

CONCLUSION

As the foregoing discussion demonstrates, the findings of the Sixth Circuit were entirely correct, guided by an unstrained application of the plain language of the statutes involved, and by the sound public policy concerns which led to the enactment of those statutes. To do other than affirm the Sixth Circuit's opinion would lead to a result unintended by lawmakers – that is the complete subjugation of the entitlements and rights of policyholders to a federal government seeking to improve its revenue position and expand its authority into an area reserved traditionally and wisely to state control. Once again, the burden of government funding falls heavily on the backs of innocent consumers. The entire state insurance regulatory system would be crippled. Congress has expressed a contrary intent throughout its history. The Ohio Commissioner is seeking to do exactly as Congress intended – regulate the business of insurance and protect policyholders.

The opinion of the Sixth Circuit Court of Appeals should be affirmed.

Susan E. Martin
General Counsel
120 West 12th Street, Suite 1100
Kansas City, Missouri 64105
Phone: (816) 842-3600

APPENDIX

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

1. The general federal priority statute, 31 U.S.C. § 3713, provides:

Priority of Government claims

(a)(1) A claim of the United States Government shall be paid first when –

(A) a person indebted to the Government is insolvent and –

(i) the debtor without enough property to pay all debts makes a voluntary assignment of property;

(ii) property of the debtor, if absent, is attached; or

(iii) an act of bankruptcy is committed; or

(B) the estate of a deceased debtor, in the custody of the executor or administrator, is not enough to pay all debts of the debtor.

(2) This subsection does not apply to a case under title 11.

(b) A representative of a person or an estate (except a trustee acting under title 11) paying any part of a debt of the person or estate before paying a claim of the Government is liable to the extent of the payment for unpaid claims of the Government.

2. The McCarran-Ferguson Act, 15 U.S.C. § 1011-12, provides:

§ 1011. Declaration of policy

Congress declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several states.

§ 1012. Regulation by State law; Federal law relating specifically to insurance; applicability of certain Federal laws after June 30, 1948

(a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

(b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance . . .

3. The federal bankruptcy statute, 11 U.S.C § 109, provides:

§ 109. Who may be a debtor

(a) Notwithstanding any other provision of this section, only a person that resides or has a domicile, a place of business, or property in the United States, or a municipality, may be a debtor under this title.

(b) A person may be a debtor under chapter 7 of this title only if such person is not –

(1) a railroad;

(2) a domestic insurance company, bank, savings bank, cooperative bank, savings and loan association, building and loan association, homestead association, credit union, or industrial bank or similar institution which is an insured bank as defined in section 3(h) of the Federal Deposit Insurance Act (12 U.S.C. § 1813(h)); or

(3) a foreign insurance company, bank, savings bank, cooperative bank, savings and loan association, building and loan association, homestead association, or credit union, engaged in such business in the United States.

(c) An entity may be a debtor under chapter 9 of this title if and only if such entity –

(1) is a municipality;

(2) is generally authorized to be a debtor under such chapter by State law, or by a governmental officer or organization empowered by State law to authorize such entity to be a debtor under such chapter;

(3) is insolvent;

(4) desires to effect a plan to adjust such debts; and

(5)(A) has obtained the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter;

(B) has negotiated in good faith with creditors and has failed to obtain the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter;

(C) is unable to negotiate with creditors because such negotiation is impracticable; or

(D) reasonably believes that a creditor may attempt to obtain a transfer that is avoidable under section 547 of this title.

(d) Only a person that may be a debtor under chapter 7 of this title, except a stockbroker or a commodity broker, and a railroad may be a debtor under chapter 11 of this title.

(e) Only an individual with regular income that owes, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts of less than $100,000 and noncontingent, liquidated, secured debts of less than $350,000, or an individual with regular income and such individual's spouse, except a stockbroker or a commodity broker, that owe, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts that aggregate less than $100,000 and noncontingent, liquidated, secured debts of less than $350,000 may be a debtor under chapter 13 of this title.

(f) Only a family farmer with regular annual income may be a debtor under chapter 12 of this title.

(g) Notwithstanding any other provision of this section, no individual or family farmer may be a

debtor under this title who has been a debtor in a case pending under this title at any time in the preceding 180 days if –

(1) the case was dismissed by the court for willful failure of the debtor to abide by orders of the court, or to appear before the court in proper prosecution of the case; or

(2) the debtor requested and obtained the voluntary dismissal of the case following the filing of a request for relief from the automatic stay provided by section 362 of this title.

4. The Ohio Insurers Supervision, Rehabilitation, and Liquidation Act, Ohio Rev. Code Ann. 3903.02, 3903.03 and 3903.42 provide:

§ 3903.02. "Insurers Supervision, Rehabilitation, and Liquidation Act"

(A) Section 3903.01 to 3903.59 of the Revised Code may be cited as "the insurers supervision, rehabilitation, and liquidation act."

(B) Sections 3903.01 to 3903.59 of the Revised Code do not limit the powers granted the superintendent of insurance under any other section of the Revised Code.

(C) Sections 3903.01 to 3903.59 of the Revised Code shall be liberally construed to effect the purpose stated in division (D) of this section.

(D) The purpose of sections 3903.01 to 3903.59 of the Revised Code is the protection of the interests of insureds, claimants, creditors, and the public generally, with minimum interference with the normal prerogatives of the owners and managers of insurers, through all of the following:

(1) Early detection of any potentially dangerous condition in an insurer, and prompt application of appropriate corrective measures;

(2) Improved methods for rehabilitating insurers, involving the cooperation and management expertise of the insurance industry;

(3) Enhanced efficiency and economy of liquidation, through clarification of the law, to minimize legal uncertainty and litigation;

(4) Equitable apportionment of any unavoidable loss;

(5) Lessening the problems of interstate rehabilitation and liquidation by facilitating cooperation between states in the liquidation process, and by extending the scope of personal jurisdiction over debtors of the insurer outside this state;

(6) Regulation of the insurance business by the impact of the law relating to the delinquency procedures and substantive rules on the entire insurance business.

§ 3903.03. Applicability of proceedings

The proceedings authorized by sections 3903.01 to 3903.59 of the Revised Code may be applied to any one or more of the following:

(A) All insurers who are doing, or have done, an insurance business in this state, and against whom claims arising from that business may exist now or in the future;

(B) All insurers who purport to do an insurance business in this state;

(C) All insurers who have insureds resident in this state;

(D) All other persons organized or in the process of organizing with the intent to do an insurance business in this state;

(E) All other companies, associations, societies, or entities subject to regulation by the superintendent of insurance under Titles XVII and XXXIX of the Revised Code.

§ 3903.42. Priority of claims distribution

The priority of distribution of claims from the insurer's estate shall be in accordance with the order in which each class of claims is set forth in this section. Every claim in each class shall be paid in full or adequate funds retained for such payment before the members of the next class receive any payment. No subclasses shall be established within any class. The order of distribution of claims shall be:

(A) Class 1. The costs and expenses of administration, including but not limited to the following:

(1) The actual and necessary costs of preserving or recovering the assets of the insurer;

(2) Compensation for all services rendered in the liquidation;

(3) Any necessary filing fees;

(4) The fees and mileage payable to witnesses;

(5) Reasonable attorney's fees;

(6) The reasonable expenses of a guaranty association or foreign guaranty association in handling claims.

(B) Class 2. Debts due to employees for services performed to the extent that they do not exceed

one thousand dollars and represent payment for services performed within one year before the filing of the complaint for liquidation. Officers and directors shall not be entitled to the benefit of this priority. Such priority shall be in lieu of any other similar priority that may be authorized by law as to wages or compensation of employees.

(C) Class 3. All claims under policies for losses incurred, including third party claims, all claims against the insurer for liability for bodily injury or for injury to or destruction of tangible property that are not under policies, and all claims of a guaranty association or foreign guaranty association. All claims under life insurance and annuity policies, whether for death proceeds, annuity proceeds, or investment values, shall be treated as loss claims. That portion of any loss, indemnification for which is provided by other benefits or advantages recovered by the claimant, shall not be included in this class, other than benefits or advantages recovered or recoverable in discharge of familial obligations of support or by way of succession at death or as proceeds of life insurance, or as gratuities. No payment by an employer to an employee shall be treated as a gratuity. Claims under nonassessable policies for unearned premium or other premium refunds.

(D) Class 4. Claims of general creditors.

(E) Class 5. Claims of the federal or any state or local government. Claims, including those of any governmental body for a penalty or forfeiture, shall be allowed in this class only to the extent of the pecuniary loss sustained from the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs

occasioned thereby. The remainder of such claims shall be postponed to the class of claims under division (H) of this section.

(F) Class 6. Claims filed late or any other claims other than claims under divisions (G) and (H) of this section.

(G) Class 7. Surplus or contribution notes, or similar obligations, and premium refunds on assessable policies. Payments to members of domestic mutual insurance companies shall be limited in accordance with law.

(H) Class 8. The claims of shareholders or other owners.